Principles of Business Credit

Eighth Edition

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NATIONAL ASSOCIATION OF CREDIT MANAGEMENT
Driving results

PART III

EXTENDING CREDIT

8 Credit Policy and Procedures

DISCIPLINARY CORE IDEAS

After reading this chapter, the reader should understand:

- The purpose of a credit policy.
- The advantages of an implied over a written credit policy.
- How a credit policy is developed.
- The components of a credit policy.
- How to create an effective credit department.
- Establishing terms of sale and credit limits.
- How to handle collections and bad debts.
- Types of credit procedures needed.

Chapter Outline

Questions for Discussion

THINK ABOUT THIS

Q. Can a credit policy be flexible enough to accommodate a changing business and economic environment?

Q. As the company's goals change with the market, how does the credit department ensure that its policies can reflect those changes?

Defining Credit Policy

- Begins with the establishment of objectives
- Written vs. Implied Policy
- Importance of Credit Policy
  - **Credit policy**
  - **Credit procedure**

Developing a Credit Policy

- **Establishing the credit standard**
- **Determining credit availability**
- **Setting credit terms**
- **Defining collection policy**

- In the short-term a credit **policy should be flexible**

Comprehension Check
What is the difference between an **implied** and a **stated** credit policy?

Comprehension Check
What is a **policy?**

Factors Influencing Credit Policy

- Type of customer
- Geographic location of customers
- Economic conditions
- Business conditions
- Competitive position
- Merchandising policy
- Type of merchandise
- Margins on merchandise
- Price range of merchandise

Comprehension Check

What is a **procedure?**

Comprehension Check

List the four elements of a **credit policy.**

Foundational Component of a Credit Policy

Key questions which build the foundation of a credit policy:

- What is the credit department's **mission**?
- What are the **goals**?
- What are the roles and specific authorities of the credit management and staff?
- What are the primary criteria for **evaluating customer credit**?
- What are the company's **terms of sale**?
- What are the **credit limits**?
- What does **monitoring of accounts** consist of?
- What are the normal **collection procedures**?
- When is the account considered to be a **bad debt**?
- What does **reporting to management** consist of? How often and to whom is a report made?

Credit Department Mission Statement

POINTS TO CONSIDER

- What is management's philosophy on risk tolerance?
- Should the credit function be liberal, moderate or conservative; can the company afford to take some risks?
- Will the company be flexible with payments beyond terms?
- How is the cash flow in the company?
- What is the financial strength of the company?
- What are the current and projected annual sales?
- What are the anticipated profit margins?
- What is the classification of products being sold (durable goods may have longer terms versus perishable goods with shorter terms)?
- What types of customers are in the customer base (large warehouse distributors versus small locally owned stores)?
- What is the geographic location of the customers and how will they be serviced (global distribution, national or local)?
- Are there any government regulations that may restrict terms or credit decisions?
- Are the policies and procedures Sarbanes-Oxley compliant?
- Should the credit function be centralized or de-centralized?
- What is the company's market position in the industry?
- Is the company striving to gain market share?
- How competitive is the industry the company operates in?
- What are the current economic trends?

Credit Department Objectives

1. Develop an optimal level of sales and cash flow, while limiting delinquencies and bad debt losses
2. Minimize carrying costs for accounts receivable.
3. Minimize risk and bad debt losses
4. Monitor operating costs and expenses
5. Convert accounts receivable to cash as quickly as possible.

- Many companies monitor standard benchmark statistics to assess progress toward company goals.

Comprehension Check
What questions build the foundational components of a credit policy?

Credit Policy

- Boundaries: Organizational Roles, Responsibility and Authority
- Credit Evaluation
- Terms of Sale
- Credit Limits
- Monitoring Accounts
- Collections
- Bad Debt
- Deductions
- Reporting to Management
- Review of Credit Policy

Credit Policy: Boundaries and Credit Evaluation

- **Boundaries**

POINTS TO CONSIDER

- Has the company clearly communicated who has overall responsibility for the credit and accounts receivable functions?
- Who has the authority to approve credit applications?
- Who has the authority to change credit limits?
- What is the credit function's credit line approval hierarchy (how much each person is authorized to approve)?
- Do credit limits above a certain amount require approval from company's senior management?
- Who has authority to hold orders?
- Who has authority to shut off accounts?
- Does the sales department have authority to override the credit manager? What circumstances require the intervention of sales? Who has ultimate authority if sales and credit do not agree?

- **Credit Evaluation**

POINTS TO CONSIDER

- Are credit applications obtained from all prospective customers?
- Do guidelines specify the types and sources of credit information to obtain on prospective customers?
- Are the company's methods for evaluating credit information and making credit decisions reasonable and consistently applied?
- Has the company considered dividing customers into categories based on sales volume and/or credit risk?

Credit Policy: Terms of Sale and Credit Limits

- Terms of Sale

POINTS TO CONSIDER

- What sales terms are acceptable within the industry?
- Are terms clearly documented and communicated to the customer?
- Are requests for special terms documented and approved in advance by the credit manager or equivalent authority?
- Does the company consider antitrust laws, such as the Robinson-Patman Act, when it offers or grants special terms?
- Does the company have more than one product line that may require different terms?
- Does the customer understand at what point the terms begin (invoice date, date invoice is received by customer, or date product is accepted by customer)?
- If early payment discounts are offered, has management considered the cost of such discounts?
- Does the company assess late payment penalties against delinquent accounts? If so, does the company take into account the cost of calculating, billing and collecting the assessments?

- Credit Limits

POINTS TO CONSIDER

- Are credit limits assigned to customers to help control credit risk?
- Has the financial strength of the creditor been considered in establishing credit limit parameters?
- Are credit limits determined logically and consistently, then properly approved?
- Are sales and customers promptly notified of credit decisions and limits?
- Are customer's credit exceptions monitored daily, such as, exceeding credit limit and/or past due situations, to proactively manage risk/customer exposure?
- Is written approval required by the credit manager if orders exceed the pre-approved credit limit or if the customer has past due invoices?
- Does the credit department review larger credit limits on a periodic basis?
- Are all credit limits subject to revision, based on changing levels of creditworthiness?

Credit Policy: Monitoring and Collections

- Monitoring

POINTS TO CONSIDER

- Do policies and procedures address how often to re-evaluate credit for existing customers?
- Are critical customers evaluated at least annually?
- Does management use other tools besides the A/R aging report to monitor credit?
- What other data sources are used for the purpose of account monitoring (sales associates, trade magazines, news wires, business and credit information companies)?
- Are credit re-evaluations for smaller customers performed at the first sign the customer is facing possible financial trouble?
- Do credit personnel check each customer's credit status (credit limits and past due invoices) before releasing orders?
- Who has the approval to release orders if a customer has exceeded its credit limit or if invoices are past due?
- Does the credit policy identify other approaches to reduce credit risks for marginal accounts, such as obtaining a security interest or guarantee?

- Collections

POINTS TO CONSIDER

- Has the company established a clearly defined process for collecting past due accounts, beginning when an account first becomes delinquent and continuing until the debt is collected or when the collection cost exceeds the benefit?
- Does the company use multiple collection strategies (telephone, email, fax, letter)?
- Does the credit policy contain a statement that reinforces ethical behavior and credit professionalism when communicating with customers and salespeople?
- Is there a policy for when to place an account on credit hold and does it have the buy-in of sales?
- Are customers and customer service, shipping and sales personnel notified immediately, as applicable, of a potential credit hold situation before the hold actually goes into effect?

Real World Perspectives

RWP 8-1

TEXTING WORKS BEST

Connecting with clients who owe your business money can in some cases present a challenge. Particularly in a world with so many options for communication, from cell phones to email, finding the right medium to relay messages that an account is late, or very late, and must be paid is of the utmost importance. As we all know, the longer our business waits past the due date for payments, the less likely we'll see payment on that account.

When trying to reach high profile or troubled accounts, one method I began using more and more over the past four years is text messaging. In fact, these days I rarely leave a voicemail if I don't reach someone. That's because I don't think many people actually listen to voice messages nearly as much as they look at a text. A person may be in transit, busy or in a meeting. But even if someone is in a meeting, they can still respond to a text. And generally, my customers do. It doesn't work all of the time, but it usually works the first couple of times, at least until they realize who it is. Also, with clients who have an iPhone, I'm able to see if the person read the message. With voicemail or even email, it's common that people don't hear or respond in a timely way, if at all.

Texting technology has improved the collectability of accounts, and that's mainly a matter of the improved means of communication. The more communication you have, the more of a customer's story you have and the more likely you are to collect on your invoices. Now, just because you're in contact sooner with your customers doesn't mean they'll have the money to pay you, but it does mean you'll have the chance to understand their situation a little earlier in the process. Every customer has a finite amount of money, so if I can beat the other vendors to the table, then I've succeeded in reaching them that much sooner and will ultimately have fewer problems collecting down the road.

In terms of texting etiquette, we're still figuring that out as we go. The best method I find so far, though, is to first identify myself, then get to the point quickly by saying something like: "Hi, I'm with company X. Your account is past due. Give me a call to work out arrangements." If you don't identify yourself, it winds up slowing how the client responds to an unknown sender. Generally, I don't put dollar figures in the first text with a client, but if the conversation takes on a life of its own, then absolutely, I include dollar amounts. With one particular client that I've been texting back and forth with for a while, I'll send him a text with just a question mark. We're so familiar with each other, he'll understand that to mean "Where's my payment?" He'll eventually come around to paying me because he knows what I'm looking for. Another benefit to using text messages is that, unless the users have deleted the message string, they'll be able to quickly scan previous texts and grasp the gist of those collections conversations.

To date, most of our customers aren't paying through text messages. We do have Square (a credit card processing service) and are setting up Apple Pay (a mobile payment service), so we know we'll be able to receive payment this way, but it's not something we've taken on yet, though it's likely just a matter of time before we do.

Shane Norman, CCE, is the credit manager at Wheeler Machinery in Salt Lake City

Credit Policy: Bad Debt and Reporting to Management

- Bad Debt

POINTS TO CONSIDER

- Does the company prepare a Reserve/Allowance for Bad Debt on a consistent basis?
- Is there a collection process in place to determine when an account balance should be considered uncollectable?
- Are bad debt write-off approval amounts assigned to departmental personnel, as set by the hierarchy of authorization levels?
- Do credit professionals participate on creditors' committees?

POINTS TO CONSIDER

- Are deductions handled promptly to assure quality receivables?
- Do customer inquiries receive immediate attention?
- Does the company share receivables and trade information with credit bureaus or credit associations?
- Is business information shared in compliance with NACM's Canons of Business Credit Ethics?
- Does management periodically review and revise credit policies and procedures, as necessary, to reflect changing business conditions?

- Reporting to Management

POINTS TO CONSIDER

- Does the company prepare reports that monitor the performance of the accounts receivable function?

  Such as:
  - Accounts receivable aging analysis, including amounts and percentages of delinquent accounts in each aging category.
  - Accounts receivable turnover or days sales outstanding ratios.
  - Bad debt/recovery analysis.
- Are reports of such information prepared at least monthly, and the results compared to preceding periods and industry statistics?
- Are reports distributed to relevant parties as determined by guidelines or needs of the company (e.g., senior management, sales, controller, etc.)?

Checklist for a Well-Defined Credit Policy

1. Formal organization of department.
2. Job description, titles and review process.
3. Credit department budget guidelines.
4. Credit documentation required for credit file.
5. Methods of gathering credit information.
6. Time limits for credit decisions.
7. Establishment of terms of sale.
8. Established credit lines and procedure for establishing new lines.
9. Procedure for communicating the decision to the customer.
10. Procedure for communicating the decision to management.
11. Procedure for communicating the decision to the sales department.
11. Procedure for communicating the decision to operations.
12. Guidelines for dealing with and assisting marginal accounts.
13. A collection policy that reduces borrowing cost.
14. A collection policy that deals with slow-paying accounts.
15. A collection policy that minimizes bad debts.
16. A policy for unearned discounts/unauthorized deductions.
17. A policy for the handling of disputes.
18. A policy for the handling of returned and damaged merchandise.
19. Policies for using secured transaction for protection.
20. A policy for the use of a guarantee.
21. Guidelines for reporting to upper management.

Figure 8-1 **Example of a Credit Policy**

The credit department shall function under the supervision of the treasurer, and its activities shall be coordinated with overall corporation policy and the activities of the sales department.

It shall be the responsibility of the credit department to help build a broad and durable customer relationship for [company name] Corporation. In the performance of this duty, the credit department shall maintain a positive and constructive attitude toward [company name] Corporation's customers. Discrimination in customer relationships is to be avoided. Likewise, the credit and sales departments shall maintain a cooperative attitude, with an aim toward promoting sales.

Within the bounds of sound credit practices, the credit department shall endeavor to find a suitable credit basis on which to deal with every customer that the sales department desires to have purchase our products. The decision as to what constitutes a suitable credit basis shall rest with the credit department. From the standpoint of credit, no customer shall be denied the right to purchase our products until every means of selling to that customer has been exhausted.

Standards by which credit risks are accepted or rejected shall be flexible enough to permit the maximum of profitable sales by [company name] Corporation. Marginal credit risks are to be dealt with when they are needed to complete operating schedules, and as long they constitute a source of added net profit to [company name] Corporation.

Customer contacts are to be kept on a dignified and friendly basis, conducted so as to promote a wholesome respect for [company name] Corporation and its business practices.

Credit department practices shall be designed to permit the maximum number of orders to flow without interruption through the sales department, but to provide for interception when necessary as a means of safeguarding credit extensions.

The credit department shall keep the sales department fully informed regarding the status of a customer's account when the free flow of orders from that customer is in jeopardy.

The credit department has the collection responsibility. Sales department advice or direct help may be sought in exceptional cases.

All credit decisions shall be independently made and shall conform to requirements of law.

Credit Procedures

Credit Procedures for Credit Approval and Administration

- Terms of Sale
- Terms Codes
- Credit Instructions
- Credit Recommendations
- Credit File Information

Credit Procedures for Collections

- Normal Procedures
- Collection Schedule
- Lockbox System
- Advance Payment
- Note Arrangement
- Account referral
- Creditors' Extension Agreements
- Bankruptcy Proceedings
- Allowance for Uncollectibles and Write-offs

Summary

- A company's credit policy is typically designed and established by top-level management.
- The first step of a **credit policy** is to establish objectives.
- A credit policy can either be **implied** or **written**. A **written or stated policy** leaves fewer chances of error or misunderstanding across the organization or credit department. A written policy also ensures consistency throughout an organization as it pertains to managing its credit.
- Credit policy varies in complexity. For instance, cash only is a form of a credit policy that may be instituted by a business.
- Credit policy establishes the direction of the credit function within an organization, while credit procedures govern the steps used in the overarching principle. In order for a policy to be effective, it must be directly and explicitly related to action.
- The four essential elements of credit policy are:
  - **Establishing the credit standard**
  - **Determining credit availability**
  - **Setting credit terms**
  - **Defining collection policy**
- The short-term application of a policy should be flexible.

Comprehension Check

What credit procedures are used in evaluating credit?

Comprehension Check

What credit procedures are used for credit approval and administration?

Summary Continued…

- **General factors** that influence the role of credit within an organization include:
  - **Type of customer**
  - **Geographic location of customers**
  - **Overall economic conditions**
  - **Business conditions**
  - **Competitive position**
  - **Merchandizing policy**
  - **Type of merchandise**
  - **Margins on the merchandise**
  - **The price range of merchandise**
- The mission of a credit department should establish the long-range focus of the policy and define the purpose of the credit department.
- The five key credit department **objectives** are:
  - **Optimize sales and cash flow**
  - **Minimize carrying costs for accounts receivable**
  - **Minimize risk and bad debt**
  - **Monitor the cost of the credit department**
  - **Convert accounts receivable to cash as quickly as possible**

Comprehension Check
What credit procedures are used for collections?

Summary Continued…

- Several factors, such as terms of sale and credit risk, influence the goals of the credit department. Monitoring these factors using standard benchmarks, like days sales outstanding or average dollar amount of invoice, may be essential in reaching organizational goals.
- Within a credit policy, it is important to define organizational roles, responsibilities and authority surrounding credit decisions.
- When evaluating creditworthiness, it is always important to consider the Five Cs of Credit, while basing a decision primarily on the credit applicant's willingness to pay, taking into consideration their payment history and ability to pay, as shown by their financial situation.
- Credit policy should specify the following:
  - **Terms of sale**
  - **Credit limits**
  - **Monitoring accounts**
  - **Collections**
  - **Bad debt**
- It is critical to realize that a sale is not complete until payment is received.
- Credit and collections reporting can be categorized as: cash flow forecasting and working capital. Therefore, these can be separated into two disciplines: financial (reporting to support the financial statements) and operational (reporting to measure the performance of individuals or groups within an organization). Furthermore, a measure has no meaning unless compared to a standard.
- In order for a credit policy to remain effective, it must be reviewed and updated during specified intervals, in tandem with changing economic, market and competitive conditions. It should be reviewed based on its ability to meet the five key credit department objectives.
- Procedures must be set for both credit approval and administration and for collections. Procedures for credit approval may include: credit instructions, term codes and credit files. Procedures for collections may include: a collection schedule, advanced payments, note arrangement and bankruptcy proceedings.

9 Credit Applications

DISCIPLINARY CORE IDEAS

After reading this chapter, the reader should understand:

- The purpose of a credit application.
- How to obtain banking information.
- How the credit application acts as a contract.
- What goes below the signature line.

Chapter Outline

Questions for Discussion

THINK ABOUT THIS

Q. Why does a company need a credit application?

Q. In a perfect world, what information should be included on a credit application?

Q. How does a credit application protect a buyer and seller?

The Purpose of a Credit Application

To assist the seller in learning as much as possible about the applicant before making a decision to extend credit.

Get as much information as possible before the start of buyer/seller relationship.

A well-devised credit application is structured to assist the seller during the four stages of the buyer/seller relationship:

1. prior to extending credit,
2. during the credit relationship with the buyer,
3. during problems in a credit relationship ,
4. during litigation.

Update regularly

Creates a contract

The Credit Application as a Source of Information

- Date of application
- Applicant's complete legal name
- Address
- Phone, fax, email and website
- Federal Tax ID number (FEIN)
- Accounts payable contact information
- Years in business
- Amount of credit requested

•Leases or own

•Sales tax exemption

•U.S Resale Tax Exemption Certificates

•Type of business

•NAICS Code

The Entity Itself – The Real Customer

- Legal Status of Company: Corporation, LLC, Partnership, Sole Proprietorship
- Buyer’s Obligation to Disclose Change of Name or Legal Status
- Principals, Owners, Officers and Members
  - Laws and Regulations Covering Personal Information
- Related Business Ventures and Related Concerns

Comprehension Check

Why is it important to have the correct legal name of a credit applicant?

Bank and Trade Reference Information

Bank References

  - Bank name
  - Address
  - Account numbers
  - Bank loan officer/contact and information

- Trade References
- Free flow of completed/past information
  - **NACM Canons of Business Credit Ethics**

Comprehension Check

What is an **NAICS code?**

The Credit Application as a Contract

- Agreement to Terms and Conditions of Sale
- Switching from Credit to Cash Terms
- Terms and Conditions in Another Place
- Buyer Modification of Terms
- Interest charges
- Certification of Use provision
- Venue provision
- Third party collection and Attorney's fees
- Change of ownership
- Certification of credit application responses
- Signature
- Shipment terms

Comprehension Check
Where can one check the legal status of a public corporation?

Real World Perspectives

RWP 9-1

The following case study describes what can happen when a creditor moves forward without a signature on his/her credit application.

CREST RIDGE CONSTRUCTION GROUP, INC. VS. NEWCOURT INC.

The impact of terms contained on a credit application was recently illustrated in litigation between Crest Ridge Construction Group, Inc. ("Crest Ridge") and Newcourt Inc. ("Newcourt"). Crest Ridge, a construction company, won a subcontract to build certain sections of the Liberty Science Center in Jersey City, New Jersey. One portion of the subcontract required Crest Ridge to supply architectural wall paneling for the Center. The principals of Crest Ridge began discussions with Newcourt, a low-cost foam paneling supplier. Shortly after the discussions began, Newcourt issued a price quotation to Crest Ridge which stated that it was "subject to credit department approval." Newcourt also furnished Crest Ridge with a credit application. The terms and conditions in the credit application and price quotation did not state any specific required credit terms.

Crest Ridge returned the credit application to Newcourt a few weeks later. The completed credit application form stated that Crest Ridge had been established in 1985 and listed one banking and four trade references. Newcourt checked out the banking reference and attempted to verify the trade references. The bank reported that Crest Ridge did have an account and had an average balance of $5,000. Newcourt was not able to verify the trade references. Because it was concerned about the creditworthiness of Crest Ridge, Newcourt began to investigate other methods of guaranteeing Crest Ridge's payment.

Meanwhile, Newcourt and Crest Ridge continued to discuss the project. Crest Ridge issued a purchase order to Newcourt quoting a price and referencing Newcourt's original price quotation. Newcourt supplied samples of its wall paneling material, job specifications and calculations, three revisions of shop drawings and final drawings showing where each panel would be placed at the Center. Three months later, Newcourt wrote to Crest Ridge suspending all further work on the wall paneling project and demanding payment in full within two weeks. The letter did not mention any credit problems but instead stated that full payment was required because of the "encumbering and confusing progress and lack of receiving pertinent data necessary to satisfy the requirements on the above-referenced project." Crest Ridge attempted to contact Newcourt several times but there was no response. Crest Ridge finally went to another supplier and covered with higher-priced paneling. Newcourt never shipped any paneling to Crest Ridge.

Crest Ridge sued Newcourt for breach of contract. Newcourt argued that there never was a contract because Crest Ridge did not obtain the approval of Newcourt's credit department. The court held that although Newcourt "required" that the price quotation was subject to credit department approval, it did not act in a manner consistent with that language. It went ahead and exchanged price quotes, showed its product and acted in many ways consistent with the existence of a contract. Thus, the court ordered Newcourt to pay damages equal to the difference in amount Crest Ridge was required to pay the higher-priced supplier.

Lessons to Be Learned from Newcourt

Newcourt appears to have had a credit application procedure which left something to be desired. It required references and other information that gave it reason to be concerned about whether it would receive payment from Crest Ridge. It also supplied certain terms and conditions on its credit application that Crest Ridge executed. Newcourt did not act consistent with its terms. Although Newcourt's credit department had apparently not given its approval, Newcourt's behavior gave every indication that a deal had been made. It provided material samples, three revisions of shop drawings, fastening details, stipulations as to the color of each panel and final drawings showing where each panel would be placed. Crest Ridge believed that it had a contract with Newcourt. The court examining these facts also believed that Newcourt acted as if a contract had been made. The court found that Newcourt's demand that it be paid in full prior to any manufacturing or shipment was unjustified under the terms and conditions set forth in the credit application. The court noted that Newcourt did not supply any credit terms to Crest Ridge.

Courts are predisposed to finding that a contract exists. The court considering the Crest Ridge/Newcourt dispute was no different. The court was willing to determine that based upon the terms and conditions contained in the credit application or through the actions of the parties that Crest Ridge and Newcourt had a contract between them. In this instance, the court found that the credit application terms were for the most part disregarded by Newcourt as evidenced by its actions. Had Newcourt really wanted to rely upon its terms and specifically the requirement that its credit department must approve the transaction, then Newcourt would have had to refrain from moving ahead with performance and discussions until such time as the credit department approved the relationship or perhaps sent a letter stating that it could not proceed without the approval of its credit department. It did not. In fact, Newcourt acted as if a contract did exist up until it stated that payment must be made in advance. Newcourt had set up its credit application in many ways that should have protected it, yet Newcourt acted inconsistently in such a way that the court found that its actions dictated the terms of its contract and it was found to have breached the contract.

This material originally appeared in a past issue of Business Credit *magazine and was written by Deborah Thorne, Esq., while a partner in the law firm of Barnes & Thornburg LLP.*

Supplemental Information

- Waiver/Duty to inspect
- Escheatment/Inactivity
- Setoff Rights
- Waiver of right to jury trial
- Prejudgment remedy waiver
- Alternative dispute resolution (ADR)
- Security instrument/agreement
- Financial information
  - Buyers Obligation to Provide Financials

- Limitations on liability
- Limitations on warranties
- Liquidation damages
- Indemnification
- Force majeure

Comprehension Check

What security is needed to protect the confidentiality of customer information?

Below the Signature Line

- Consent to obtain consumer credit report
- FCRA and Guarantor or Personal Guarantor
- Personal or Corporate Guarantee
- ECOA Notice

Comprehension Check
What information should be required on a credit application?

Comprehension Check
Why do terms of sale have to be set forth in writing in a credit application?

Summary

- The credit application is crucial to the determination of the rights of the creditor in the event of a dispute with, or default of, a customer. With a well-drafted credit application, a credit professional may accomplish dual goals of limiting credit risk, addressing contingencies that may arise in a credit relationship.

- The credit application is the credit professional's first, and sometimes only, opportunity to protect their company from risk of loss through credit sales and/or fraud. This is most advantageous to obtain at the beginning of the buyer/seller relationship.

- The credit application is structured to assist the seller in four stages of the buyer/seller relationship:
  - **Prior to extending credit**
  - **During the credit relationship with the buyer**
  - **During problems in a credit relationship**
  - **During litigation**

Comprehension Check

Why is it important to specify **venue** in the credit application?

Summary Continued…

- The credit application is usually the primary source of information on a business looking for credit. Basic information for any credit application includes:
  - **Date of application**
  - **Applicants legal name**
  - **Address information including mailing address, physical address, P.O Box**
  - **Telephone number, fax number, email and website**
  - **Federal Tax Identification Number (FEIN)**
  - **Accounts payable contact information**
  - **Years in business**
  - **Sales tax exemption**
  - **Lease or ownership of real estate**
  - **Type of business**
  - **NAICS code**
- Understanding the legal structure is also an essential component of any credit application because it allows a credit manager to understand who is liable for any debts accrued by the organization.

Comprehension Check
Whose signature is needed on the credit application?

Summary Continued…

- Understanding the legal structure is also an essential component of any credit application because it allows a credit manager to understand who is liable for any debts accrued by the organization.
- A creditor can easily check the legal status of a company online with the Secretary of State's office. If a company changes it legal status, a new credit application should be signed.
- It is critical for any credit professional to understand the laws and regulations surrounding personal information. Many states also require notification to individuals concerning data breaches.
- Obtaining bank references may be necessary when extending credit. However, even though current laws do not restrict banks from providing creditors information regarding business customers, many banks have chosen to adhere to a standard "no information" policy.
- Trade credit grantors enjoy the luxury of a free flow of information, and should be willing to share their current customer information, while maintaining confidentiality if obtaining customer information from another business credit grantor. The **Canons of Business Credit Ethics** establish standards relating to the proper exchange of credit information among creditors which contains historical and current factual information to support the process of independent credit decision-making.

Summary Continued…

- It is important to remember that the process leading up to a signed credit application is a negotiation.
- It is also important to avoid violating state usury laws. Law governs how the product is used rather than how it is purchased. Therefore, the amount of interest specified can only be collected if it is in the signed agreement and has been used for business/commercial purposes, aside from “personal, family, or household purposes.” A Certification of Use Provision can be added to a credit agreement to avoid a defense by a customer who uses their business credit to buy products they intend to use for personal use. This is only necessary if the products have potential for “personal, family, or household use.”
- A **venue** provision is essential part of a credit application to ensure credit grantors will not be required to travel to bring or defend a lawsuit.
- In order to be awarded attorney fees, it is suggested that this be stipulated in the credit agreement to ensure that it is not overlooked in court proceedings.
- During a change in business ownership, a reevaluation of credit before continuing business with the organization is imperative. A new credit application should be the beginning of this new relationship.
- An authorized representative can legally bind the company even if the signer is not an officer or executive of the company.

Summary Continued...

- Alternative methods of authorizations if customers are averse to signing a credit application include:
  - Credit Card Authorization Agreement
  - Electronic Funds Transfer Authorization (EFT)
  - Management Indemnification Form
- Due to the fact that transfer of goods from seller to buyer can present substantial risk, it is important to establish who is liable in these circumstances. Based on the Uniform Commercial Code, risk of loss depends upon the terms of the agreement. This can be addressed by using the commonly accepted shipping terms (Incoterms®).
- Other supplemental information that may be included in the credit application includes:
  - **Waiver/duty to inspect**
  - **Escheatment/inactivity**
  - **Right of offset**
  - **Waiver of the right to a jury trial**
  - **Prejudgment remedy waiver**
  - **Alternative Dispute Resolution (ADR)**
  - **Security instrument/agreement**

Comprehension Check

In a **shipment contract,** when do title and risk of loss pass to the buyer?

Comprehension Check

When should **ADR** be considered? How does it differ from mediation?

Summary Continued…

- Big or small, financial information for a company should be provided. If the company is small, a variation of financial information should be provided, like an easy-to-complete balance sheet or income statement. For larger companies, financial statements should be provided.
- It is important to follow **ECOA** laws when obtaining a personal guarantee, but keys to a personal or corporate guarantee are:
  - **Payment guarantee**
  - **It should be "absolute and unconditional"**
  - **It should be "continuous"**
  - **It should be "irrevocable"**
- The ECOA also prohibits discrimination based on race, color, religion, national origin, sex, marital status or age.

Comprehension Check
What are the essential elements of a **personal guarantee?**

Comprehension Check
What is contained in the **ECOA** regulations?

10 Terms and Conditions of Sale

DISCIPLINARY CORE IDEAS

After reading this chapter, the reader should understand:

- The role played by terms in day-to-day business transactions.
- The major factors that influence terms.
- The key elements of terms.
- The types of terms and how they differ.
- The impact of payment timing and discounts on profitability.

Chapter Outline

Questions for Discussion

THINK ABOUT THIS

Q. How can terms of sale benefit the buyer or seller? Are there occasions in which the terms benefit the seller more than the buyer and vice versa?

Q. What aspects of a product can change the terms of sale?

Q. How can terms of sale and interest rates impact a company's profitability?

Important Considerations

- Applying Credit Policy to Terms
  - ACH (Automated Clearing House)
  - Open Credit Terms
- Contractual Considerations
- Antitrust Implications
  - Standard Terms

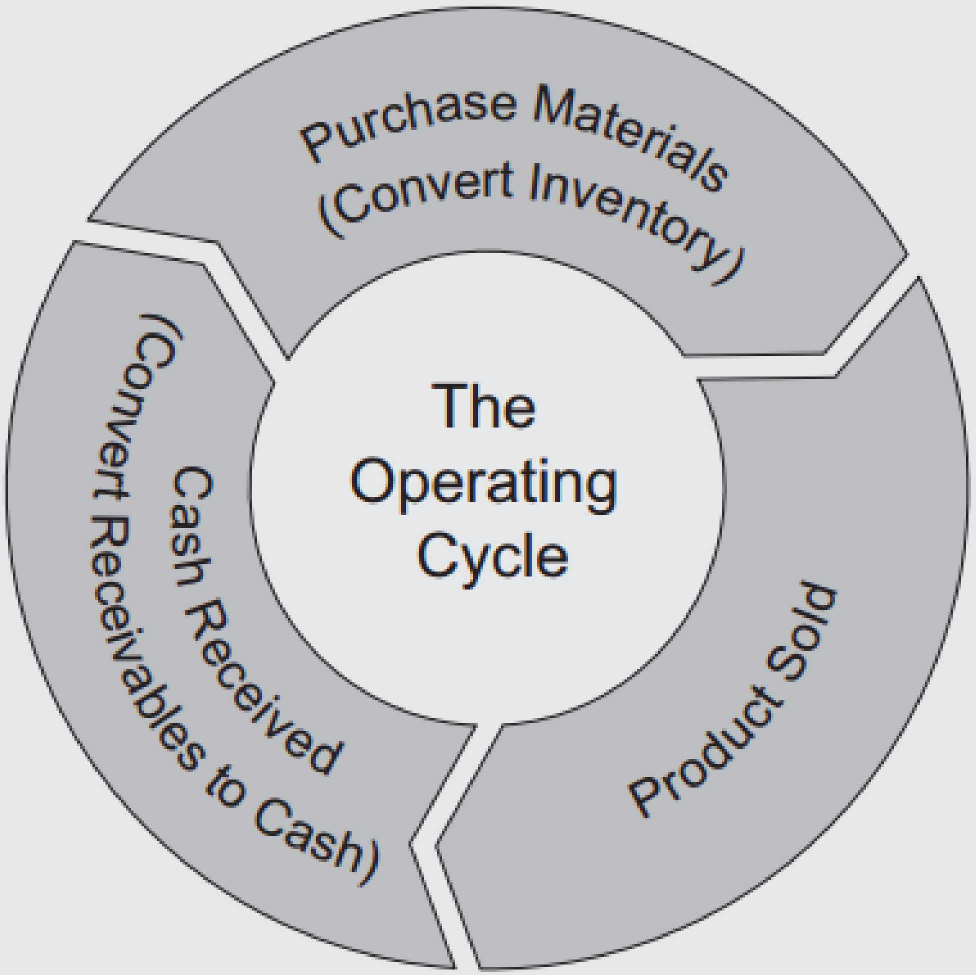
Influencing Factors

- General Considerations
- Competition
- Market and Product Characteristics
  - **Operating Cycle**
  - **(WIP) Work in progress**
  - **Perishable Agricultural Commodities Act (PACA)**
- Class of Customer
- Profitability

Comprehension Check

How does the Robinson-Patman Act apply to terms of sale?

Figure 10-1 **The Operating Cycle**



Categories of Terms of Payment

- Cash and Prepayment Terms – Closed Terms
  - CIA
  - CBD
  - CWO
  - COD
- Short Terms
  - Bill-to-Bill Terms
  - Receipt of Invoice Terms
  - Credit Card Payment
  - Purchasing Debit Cards (P-Cards)

- Open Account Terms
  - EOM Terms
  - MOM Terms
  - Proximo Terms
- Discount Terms
  - 1% 10 net 30
  - 8% 10 EOM
  - 8% 10th Prox.
  - 2% 10 MOM
  - 2% 10th Prox, net 30th
  - Anticipation,
  - Trade Discounts
  - Chain Discounts
  - Dynamic Discounts

Enforcement

Unearned Discounts

- *check for the amount due less the discount even though the discount period or terms have expired*

Inconsistent treatment of unearned discounts and enforcement of terms will create the potential for antitrust claims under the Robinson-Patman Act.

Comprehension Check

What factors influence credit terms? Provide an explanation for each factor.

Factors Influencing Offering Discount Terms

- Meet competition
- Reduce exposure
- Reduce credit and collection expense
- Reduce borrowing costs
- Put collected funds to use more quickly

Comprehension Check

What are the categories of credit terms?

What are **prepayment terms**?

List four types of prepayment terms.

Analyzing the Cost of Offering Cash Discounts

- Analysis of time value of funds –
  - **Risk premium**
  - **Cost of capital**
  - **Net Present Value** $PV = FV/(1 + k)^n$
- Future value $FV = V(1 + k)^n$
- Effect of discount terms on profit
- Effect of terms change on sales/profits
- Analyzing profits from discounted sales
- Analyzing cost to buyer of using bank loan vs. trade credit

Comprehension Check

What are the types of discount terms?

Figure 10-2 Present Value of Future Receipts Based on an Annual Cost of Capital of 12.88%

Receipts	Days	Cost of Captal	Present Value
$100	0	0	$100.00
100	30	.0107	98.93
100	60	.0215	97.85
100	90	.0322	96.78
100	120	.0429	95.71
100	150	.0537	94.64
100	180	.0644	93.56
100	210	.0751	92.49
100	240	.0859	91.42
100	270	.0966	90.34
100	300	.1073	89.27
100	330	.1181	88.20
100	360	.1288	87.12

Figure 10-3 PV of Sales at Different Payment Dates When Discount is Offered

Payment Date	0	10	11	30	60
Sale	$100.00	$100.00	$100.00	$100.00	$100.00
Cash Discount	2.00	2.00	0.00	0.00	0.00
	98.00	98.00	100.00	100.00	100.00
Cost of Carrying	0	.35	.39	1.06	2.12
Cash or Present Value	98.00	97.65	99.61	98.94	97.88
Cost at Present Value	86.00	86.00	86.00	86.00	86.00
Profit at Present Value	$ 12.00	$ 11.65	$ 13.61	$ 12.94	$ 11.88

Figure 10-4 Annual Interest Rates Applicable to Discount Terms

Cash Discount Percent (X%)	X% 15 Net 30 Days	X% 10 Net 30 Days	X% 30 Net 60 Days	X% 15 Net 60 Days	X% 10 Net 60 Days	X% 30 Net 90 Days
½	12%	9%	6%	4%	3.6%	3%
1	24	18	12	8	7.2	6
1½	36	27	18	12	10.8	9
2	48	36	24	16	14.4	12
2½	60	45	30	20	18.0	15
3	72	54	36	24	21.6	18
3½	84	63	42	28	25.2	21
4	96	72	48	32	28.8	24
4½	108	81	54	36	32.4	27
5	120	90	60	40	36.0	30

Late Charges

Reasons **For** imposing and enforcing late charges:

- Use of supplier’s capital without consent
- Allows delinquent customers unfair net price advantage
- Increases supplier’s collection and bad debt expenses

Late Charges Continued…

Reasons for **NOT** imposing late charges:

- Fear of losing customer goodwill
- Competitors may not impose/enforce late charges
- Difficulty in collecting late charges
- Heavy administrative costs
- Cost of carrying overdue accounts is small

Special (Other) Terms

- Receipt of Goods
- Bill and Hold
- Consignment
- Floor-Plan Financing
- Contra Account
- Extra Dating
- Seasonal Dating
- Security Interest
- Advances
- Progress Payments

Other Terms and Conditions of Sale

- Warranties
- Delivery
- Termination of Contract
- Title/FOB point
- Indemnification
- Liability
- Conditions Precedent to Buyer's Obligation
- Arbitration Clauses
- Conditions of Default
- Applicable Law

Comprehension Check
What are receipt-of-goods terms?

Comprehension Check
What is a consignment term?

Export Terms

- Pro Forma Invoice
- Barter Arrangements
- Incoterms®

Comprehension Check

What is **floor-plan-financing?**

The "Battle of the Forms"*

- The fine print terms on the offer often conflict with the fine print terms on the purchase order.
- Firm Offers and Price Quotes
- Responses and Confirmations
- UCC Gap Fillers
- Established Limitations
- Credit Agreement or Master Supply Agreements
- Modification of Contracts
- End of the Battle of the Forms

Comprehension Check
What are **extra dating arrangements?**

Comprehension Check
What are **seasonal dating terms?**

Summary

- There is a direct relationship between the terms of the sale and the seller's perception of the buyer's ability to pay. In an extreme example, if a seller has no faith that a buyer will pay, the immediate payment in cash, or in other forms, may be required.

- It is important to note that not all sales are governed by signed contracts, especially when there is frequent activity between the buyer and the seller.

- When changing terms, or when changing **standard terms** for a particular buyer, the seller must ensure that they are not in violation of antitrust laws, particularly price discrimination laws set by the Robinson-Patman Act. Legal counsel in these circumstances is suggested.

- Two major influencing factors for terms of sale are **competition**, and **market and product characteristics**.

- When there is competition in the market, a sale may not take place without the extension of credit. Price is an extension of various factors including competition, and it is necessary to view the terms of a sale as a component of price.

- Customers prefer terms that cover their **operating cycle**. Having terms that are shorter or longer than a buyers operating cycle may indicate more favorable terms for either the buyer or the seller.

Summary Continued…

- Terms differ widely by industry. Common terms for perishable items are 7, 14, or 21-day terms, while chemical products that have a longer storage time generally have longer terms of sale.
- Class of customer or profitability of a product may also lend itself to different terms.
- The three categories of terms of payment are as follows
  - **Cash and prepayment terms**
    - **Cash in advance (CIA)**
    - **Cash before delivery (CBD)**
    - **Cash with order (CWO)**
    - **Cash on delivery (COD)**

- **Short term**
  - **Bill-to-bill**
  - **Receipt of invoice terms**
  - **Credit card payment**
  - **Purchasing Debit Card (P-cards)**
  - **Cashier's check or certified check**
  - **Wire transfer**
  - **Electronic funds transfers (EFTs)**
- **Open account terms**
  - **End-of-month (EOM) terms**
  - **Middle of the month (MOM) terms**
  - **Proximo Terms**

Summary Continued…

- **Open account terms** include at least three elements: **net credit period, cash discount and the cash discount period**.
- Electronic payments are the typical form for international, cross-border payments.
- It is a necessity to spell out any discount policy on the credit application or in the contract in the terms and conditions section.
- Types of discounts include:
  - Anticipation
  - Trade discounts
  - Chain discounts
  - Dynamic discounting
- Enforcement of discounts varies widely. However, it is essential to create a company policy that is used consistently on all customers, because unearned discounts can create potential antitrust claims under the Robinson-Patman Act.

Comprehension Check

What is a **pro forma invoice**?

Summary Continued…

- The credit manager should play an important role in determining discount terms. Some of the most compelling reasons to offer discounts include:
  - Competitive conditions
  - Reduction of credit exposure, delinquencies, credit losses
  - Reduction of credit and collection expense
  - Reduction of borrowing costs
  - Improvement of cash flow and investment opportunity
- Decisions to offer early payment discounts or to change the amount of the discount often require a detailed analysis of their economic impact. This includes an analysis of how the net present value affects the profitability of terms.
- The seller's credit team can also use the **cost to the buyer formula** to convince a buyer that taking a bank loan may be a cheaper option for the buyer. This allows a buyer to generate internal profits, but also improve the speed of payment for the seller.
- If a bill is not collected at maturity, it may be necessary to institute **late charges**, because late payments incur costs that have not been accounted for by the seller.

Summary Continued…

- Special terms may be beneficial for certain industries or special circumstances that a buyer and seller may find themselves in. **Special terms** include:
  - **Receipt of Goods**
  - **Bill and Hold**
  - **Consignment**
  - **Floor-Plan Financing**
  - **Contra Account**
  - **Extra Dating**
  - **Seasonal Dating**
  - **Advances**
  - **Progress Payments**
- There are also special terms for international trade known as **export terms.** Some export terms are as follows:
  - **Pro Forma Invoice**
  - **Barter Arrangements**
  - **Incoterms®**

11 Credit Investigations

DISCIPLINARY CORE IDEAS

After reading this chapter, the reader should understand:

- How to conform to the legal requirements and ethical principles of credit investigation.
- The sources of direct credit investigations.
- The sources of indirect credit investigations.
- The importance of conducting credit investigations on existing accounts.
- The sources of international credit investigations.

CHAPTER OUTLINE

Questions for Discussion

THINK ABOUT THIS

Q. What ethical considerations should be taken into account when investigating a customer's credit worthiness?

Q. When does a customer visit become beneficial to a credit professional?

Q. What value does an industry credit group bring to a credit investigation?

Legal and Ethical Aspects of Credit Investigations

Legal Perspectives:

- Exchange of Credit Information – The Legal Perspective
- Antitrust in Credit Investigation
  - Conspiracy, Restraint of Trade, Joint Actions
- Defamation in Credit Investigation
  - Libel and Slander
    - **Examples**
    - **Matter of Libelous per se**
  - Defenses to Charge of Libel
    - **Privileged communications**

Exchange of Credit Information – The Ethical Perspective

- Confidential Nature of Credit Information
- Summing Up Ethical Considerations
  - **Personal Behavior**
  - **Honesty**
  - **Objectivity**
  - **Topics to Avoid**
- Company Policy

Comprehension Check

Explain the terms **libel, slander** and **matter libelous per se,** providing an example of each as it pertains to credit management.

Direct Credit Investigations

- Creditor collects information through direct contact with customer or noncommercial sources, such as competitors, banks and other trade references
- A Direct Credit Investigation can include:
  - Customer Visits
  - Trade References
  - Other Sources of Direct Investigation
    - Bankruptcy Court, Internet, Customer Website, Specialized Information

Customer Visits

The benefits of customer visits by credit department representatives include:

- Developing and enhancing the customer relationship.
- Strengthening the relationship with the sales department.
- Observing customer facilities (the inventory, condition of the equipment, the plant, the location and attractiveness of retail operations, etc.).
- Discussing financial information in more depth.
- Reviewing financial information that might otherwise be unavailable.
- Observing how other suppliers' products are being used.
- Developing connections between various internal company functions and the customer's counterparts (i.e., logistics departments, advertising departments, etc.).
- Resolving disputes.
- Sharing best practices.
- Discussing account status and collection of payments.

Comprehension Check

Define **direct credit investigation.**

Figure 11-4 Questions to Ask Customers

1. What is their corporate structure?: Is it a corporation, partnership, LLC, LLP or proprietorship?
2. Do they have affiliated companies? If so, what is their relationship to the company being investigated (vertical: supplier or end-user; horizontal: differentiated by product type or geography, etc.)?
3. What is their product cycle, from ordering to shipment of raw materials to finished product to receipt of cash? What is the impact of seasonality on their business?
4. What are their inventory policies? Are there markdown procedures in place, or other plans to relieve slow-moving stock? What is the size of order backlogs?
5. Who are the principal customers of the company being investigated? How would their creditworthiness be described?
6. What terms of sale do they offer to their customers? What is the payment performance of their customers?
7. What is their market share? What is their product niche? Who is their competition, their advantages or disadvantages (price/quality/delivery), and their relative market shares?
8. Are there plans for expansion, new product developments or curtailments of unsuccessful lines? How will any expansion be financed? How will overhead be eliminated or absorbed if unsuccessful lines are curtailed? Are the facilities owned or leased? If leased, what are the expense implications if facilities are closed? Are the plans realistic?
9. Who are their major suppliers? What terms do they offer? Do any of them hold letters of credit, guarantees or security instruments such as liens?
10. What are projections for sales and income? What factors would influence possible variances?
11. What are their borrowing arrangements (availability, advance rates, factoring arrangements, security held, mandatory cleanup periods)?
    - What is the impact of seasonality?
    - Is refinancing under consideration?
    - Are personal assets or assets of affiliated companies pledged?

Real World Perspectives

RWP 11-1

RECLAMATION FROM DOLLARS TO TEARS

Clarence, the store owner, forcefully and purposefully handed me the keys to the store and said to me, "It's yours!" I was in shock by the turn of events, never expecting a customer to simply hand me the keys to their business! Although not prepared for this drama, I told Clarence that I was there to find a mutually agreeable solution to address the pharmacy's delinquency issues. Clarence began to listen to me closely, while cautiously still displaying some fear and trepidation.

Reflecting back to my interactions with Clarence before our first face-to-face meeting, maybe his behavior should not have surprised me. Clarence, the owner of a small drug store in St. Louis, would never commit to a payment plan and with great reluctance he agreed to our meeting. The meeting time also was unusual—7:00pm, after the store had closed. Clarence's slow opening of the store's entrance door confirmed a lack of trust and a feeling of dread to meeting with the "Credit Manager" from Chicago! The behavior may have been a tip off, the store keys being handed to me by Clarence, however, seemed to be a little over the top. All I knew was that I was going to have my work cut out for me.

The pharmacy was built in 1894, and Clarence certainly had a long history with the pharmacy. He told me about working in this drug store in high school and purchasing the drug store shortly after graduating from pharmacy school, fulfilling his boyhood dream. Clarence went on to tell me about the quadruple bypass surgery that he had in the prior year and the resulting health complications which led to his current financial difficulties. Being unable to work for six months, Clarence had to hire a pharmacist and manager for the store, increasing his expenses significantly. Furthermore, the newly hired personnel mismanaged the drug store.

My face-to-face meeting with Clarence would not be my last, although it helped build a foundation of trust on both personal and business levels between Clarence and me. I appreciated Clarence's sincere and honest overview of his financial difficulties, and I could tell that Clarence was truly a man of good character. I asked Clarence to put together the store's financial information and told him I would visit the next time I was in St. Louis. Clarence agreed to my request.

RWP 11-1 continued...

Two weeks later, I was again on a plane to St. Louis to see my friend Clarence. When I arrived we went back to the prescription dispensing counter as we had done at our first meeting to review the financial statements (if that was what you would call them). Essentially, it was a list of assets written on a green legal pad. It even included a bicycle from the 1950s used to deliver prescription orders! We went through the inventory items and discussed inventory management opportunities to improve his cash flow along with the store's operating performance and profitability. At the end of our meeting, we arrived at a mutually agreeable payment plan. Clarence told me that the payment plan would also require the approval of his attorney.

As I returned to Chicago, I thought that I was in a continuous loop leading to no resolution. I had already made a substantial investment with my time. I expected that the attorney, who was a friend of the family, would put up additional roadblocks due to the fact that I was requesting to become the only secured creditor for all of the business assets.

I did go through a challenging tug-of-war with Clarence's attorney and was now ready to finalize our agreement. Once again, I was on a plane to St. Louis to see Clarence. When I arrived, Clarence happily greeted me and we walked to the prescription dispensing counter. I went through each document and explained its purpose and significance. Clarence appreciated my attentiveness to these details and then I advised him where he needed to sign and date the documents in order to fully execute our agreement. Clarence slowly and carefully raised the documents to view at eye level and then he began to cry, telling me, "Shane, I thought there was no way out." I put my arm around his shoulder and told him that everything was going to be all right.

The next day Clarence's attorney called me by phone to thank me for helping her client and that it was a pleasure to work with me. A week followed and Clarence called me to tell me how he appreciated everything I had done for him. The whole experience was now indelibly stamped into my mind.

By helping business owners, I have learned that you not only can make a difference in their lives, but also make a difference in the lives of their families, the employees and their families, and the communities they serve. Look for the "Clarences" in your business and make a difference in their lives!

Shane Stevenson, CCE

Customer Visits: *Preparation*

The following preparation checklist will help ensure a successful visit:

- Define the objectives of the meeting.
- Determine who will attend the meeting and arrange a brief pre-meeting conference to agree on objectives and visit details.
- Schedule the meeting with all parties so that ample time is allotted for all necessary discussions.
- Review all relevant receivables and financial information such as detailed account status, financial statements and credit file material, noting any additional information needed.
- Obtain as much information as possible from other departments. What is the sales department's opinion of the account? Are distribution and other policies being properly observed by the customer? What is the unshipped order position? Review customer purchase orders for terms, prices or other issues. Are invoices being billed to the correct address?
- Contact other credit managers who may have visited the account recently and be certain credit investigation information is up to date.
- Prepare a follow-up list of things to be accomplished or learned.

Comprehension Check

Explain the benefits of visiting a customer.

Trade References

is the payment experience information provided by a supplier on its customer

Trade references are comprised of base variables, which represent the creditworthiness of the suppliers' customers, such as the following:

- Reporting date.
- Manner of payment, whether customer payment is prompt or slow, and by how many days.
- Rolling 12-month high credit (highest amount of credit used).
- Current total amount owing.
- Current total past due.
- Selling terms or days beyond terms.
- Date of last sale.
- Length of time the supplier has sold the account.
- Whether supplier referred account to a collection agency or if a history of NSF checks.
- Other facts about the customer's purchase and payment records.

Comprehension Check

What questions can a credit manager ask a customer during a visit?

Trade References: *Bank Information*

A proper inquiry should contain:

1. **Subject**
2. **Purpose**
3. **Experience**

Figure 11-7 Statement of Principles for the Exchange of Credit Information

1. Confidentiality is the cardinal principle in the exchange of credit information. The identity of inquirers and sources should not be disclosed without their permission.
2. All parties involved in the exchange of credit information must base inquiries and replies on fact.
3. The purpose of the inquiry and the amount involved should be clearly stated.
4. If the purpose of an inquiry involves actual or contemplated litigation, the inquirer should clearly disclose this fact.
5. The inquirer should make every effort to determine the subject's bank(s) of account before placing an inquiry, and indicate the extent of information already in the file.
6. Proper identification should be provided in all credit communications.
7. Replies should be prompt, containing sufficient facts which are commensurate with the purpose and amount of the inquiry. If specific questions cannot be answered, the reasons should be clearly stated.

Other Sources of Direct Investigation

- County and State Government Offices
- Bankruptcy Court Information
- Internet
- Customer Websites

Comprehension Check
What key factors should be observed during a customer visit?

Indirect Credit Investigations

- *Third-party sources in the business of preparing information on businesses as opposed to individuals*
- Industry Credit Groups
- Commercial (Business) Credit Reporting Agencies
    - **General Credit Reporting Agencies**
    - **Specialized Credit Reporting Agencies**
    - **Aggregating Credit Reporting Agencies**

Comprehension Check

What are some important steps in the follow-up process?

International Credit Investigation

- Customer-Supplied Information
- Bank Information
- Exporter's Foreign Sales Representative
- International Credit Reporting Agencies
  - FCIB
    - International Credit Reports
    - Country Reports
  - Organization for Economic Cooperation and Development (OECD)

Comprehension Check

When contacting a bank about a potential account, what information should the inquiry contain?

Comprehension Check

If a bank reports that an account balance is in the medium four-figure range, what is the numeric balance range for this account?

Provide the numeric figure ranges for the following dollar ranges: (a) Nominal, (b) 5 figures.

Investigating Existing Accounts

- When to Investigate an Existing Account
  - *Periodic Updating*
  - *Special Event Updating*
    - Reviews for updates should occur for any of the following events:
      - An account that usually purchases small amounts, suddenly placing large orders.
      - A prompt payer suddenly beginning to pay slowly.
      - A lot of inquiries suddenly coming in about an account.
      - A change in ownership or legal business structure of an account.
- Strengthening Customer Relations
  - *Written Communication*
  - *Periodic Requests for Financial Statements*
  - *Revisions of Credit Availability*
    - ***ECOA** notification of **adverse actions***
  - *Sales Reps*
- *Sources of Information*

Comprehension Check

In addition to trade references and banks, what sources are available when conducting a direct investigation?

Comprehension Check

What sources are available when conducting an indirect investigation?

What are the types of commercial credit reporting agencies?

Summary

- The exchange of credit information is legal as long as the information transferred is restricted to factual, historical data. In particular, the information given cannot represent any action that has yet to occur.

- The core principles for exchanging business credit information in any setting are: **antitrust, anti-defamation** and **confidentiality.**

- This is particularly important as it pertains to antitrust regulations. The intent of antitrust regulation being to avoid any behavior that could lead to conspiracy, restraint of trade, price setting or fixing, or boycotting certain customers or suppliers.

- A creditor must be careful to avoid any kind of defamation. **Defamation** being any occurrence of **libel** or **slander.** This includes matter **libelous per se.** A simple way to understand it is to say: if it hasn't happened yet, then it should not be reported.

- Truth is a complete defense to an action in libel. Some defamatory statements are not considered actionable because they are considered privileged communications, unless the purpose of the actions can be proved to be of malicious intent.

- The relationship between credit professionals needs to be one of trust. A credit professional must feel confident that the information they are providing will remain confidential. That being said, the person seeking the information must take extra care to keep the information confidential. Any breach of confidence may cause the exchange of credit information to simply "dry up."

Summary Continued…

- The credit granter must trust that:
  - Information provided is accurate and factual
  - The information will be used solely by that individual to make a credit decision
  - The information will not be repeated to any other party
- Ethical considerations should be made for the following:
  - Personal behavior
  - Honesty
  - Objectivity
  - Topics to avoid
- Direct credit investigation used to be the norm, and its use has since diminished as the availability of online information has increased. Direct credit investigations include:
  - **Customer visits**
  - **Trade references**
  - **County and state government offices**
  - **Bankruptcy court information**
  - **The Internet**
  - **Customer website**

Comprehension Check
What sources are available when conducting an international investigation?

Summary Continued...

- Customer visits may be essential to ensure the creditworthiness of a customer. The following are a few benefits of visiting the customer:
  - Enhancing the customer relationship
  - Strengthening the relationships between departments
  - Discussion of financial information in more depth or that is otherwise unavailable
  - Observing the facilities
- It is essential to be prepared when going on a customer visit. The credit professional should be prepared for each visit with a written agenda, list of questions, time frames and participants.
- Banks may have their own rules about providing customer information, and may be cautious when releasing the information about their customers. When requesting information from banks and suppliers, creditors should do the following:
  - Indicate the purpose of the inquiry
  - Clearly identify the inquirers organization
  - Clearly communicate the amount involved

Comprehension Check

When should existing accounts be reviewed?

Summary Continued…

- Indirect investigation includes:
  - **Industry credit groups**
  - **Commercial credit reporting agencies**
    - **General credit reporting agencies**
    - **Specialized credit reporting agencies**
    - **Aggregating credit reporting agencies**

Comprehension Check

How can customer relations be strengthened?

- The four major credit reporting agencies are: NACM, D&B, Experian and Equifax. Third-party sources, such as the ones mentioned, have on file, or can gather information directly, that could be too time consuming or costly for most businesses.

- International credit information is available, but more difficult to obtain. The information can be obtained from customers, banks, the exporter’s foreign sales representative or international credit reporting agencies. An excellent example of an international reporting agency would be the Finance, Credit and International Business Association (FCIB), which is a subsidiary of NACM.

- Investigating existing accounts should occur periodically due to special events, such as a sudden increase in purchase volume or a prompt payer suddenly beginning to pay slowly.

- Investigating existing accounts can strengthen customer relations and improve sources of information, ultimately reducing the risk to the creditor.

Principles of Business Credit

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