



**THE CREDIT DEPARTMENT, INC.**  
*SMART BUSINESS. STRATEGIC VALUE.*

November 2004

*“Improving cash flow and earnings through strategic credit management.”*

## A Million Dollar Mistake

A prospect called, frantic that his customer owed \$50,000, which was 60 days past due. He sent me his “credit file”: a completed credit application and an invoice. When the prospect had tried to collect, there was no answer. Our investigation showed a very small bank balance, tax liens and a long list of unpaid creditors. Sadly, the non-paying customer had *never* been in a position to handle a \$50,000 credit line, and the prospect hadn’t understood the risk. Based on the prospect’s net profit margin of 5 percent, it’ll take *\$1 million in new sales* to make up for this mistake. For many small companies, this scenario is too familiar. Thankfully, it’s usually preventable.

Here’s what you can do to prevent your million-dollar mistake:

### **1) Credit policy**

- Establish a written policy with your Sales and Finance Departments so that everyone agrees how to handle customer credit.
- Determine your “insomnia risk”—that is, individual customer credit amounts that would keep you up at night if lost. For most small companies, it’s somewhere between \$2,500 and \$10,000. Spend resources to thoroughly analyze these and larger risks.
- Standardize your terms of sale and stick to it. Don’t have different terms for customers unless you are “treating all like customers alike” to comply with anti-trust laws. Consult your attorney if you aren’t sure. Remember: the shorter your terms, the faster you’ll collect your receivables.
- Establish minimum requirements for a customer to obtain credit (i.e., bank balance, years in business, etc).
- Set up a monitoring schedule for credit line renewals (at least yearly).

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*The Credit Department, Inc. can help you manage your credit needs through professional credit management outsourcing and consulting. For more information, contact us at 800.451.0164, email [info@TCD.com](mailto:info@TCD.com) or visit our web site at [www.TCD.com](http://www.TCD.com).*

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## 2) **Extending credit:**

- Have ALL customers sign a credit application before you set up an account.
- Always obtain a bank reference on your customers.
- Don't rely on those trade references the customer lists. They may be the only three creditors they pay on time!
- Pull credit reports on customers exceeding your established "minimum credit lines". Both D&B and Experian provide good, low-cost reports so you can see how the business pays ALL vendors as well as bankruptcies, liens/judgments, and other credit lines extended. Usually, Experian's intelliscore reports and D&B's Credit Scoring reports are sufficient for credit lines under \$100,000. Small businesses can purchase Experian reports from resellers without upfront contract minimums.
- If the credit line is very large (six-figures), get customer financials. If you don't know how to analyze for bankruptcy risk, find someone who can.
- We highly recommend developing credit scorecards to fairly and accurately assess credit worthiness. The credit scores created by commercial bureaus work well as "elements" in scorecards but shouldn't be **the** deciding factor in determining credit lines. Don't grant credit on "gut feel" when so much information is readily available.
- Don't extend credit to consumers or to new businesses—the risk is usually too high.

## 3. **Collections.**

- Most importantly, follow-up, follow-up, follow-up. If the customer says they'll send a check on Friday, call Friday to make sure the check went out. If customers know you won't call until the last week of the month, they won't pay before then.
- Don't substitute form letters for more effective phone calls.
- Ensure you have strong customer contracts, clearly spelling out terms and conditions of the sale. Don't accept purchase orders with extended credit terms.
- If the customer won't respond to your requests for payment or won't agree to a payment plan, SEND TO A THIRD PARTY or go to conciliation court. Don't hang onto the file until it's impossible to collect.
- If the customer can't pay in full, always negotiate a plan with partial payment NOW.
- Understand that you're competing with other unsecured creditors; hire a strong negotiator for collections.
- Never, ever threaten any action you won't follow through on.
- Make sure you organize the collection work in a contact database. Collectors should know their daily tasks, based on a prioritized collection system (using credit risk and dollar amount). Streamline processes to avoid redundancy and don't use old techniques like writing on paper agings or sticking post-its all over desks.

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- Don't follow some pre-determined collection schedule like "call at 30 days", "letter at 60 days", etc. This will unnecessarily prolong receivables collections.
- Finally, when you write off a receivable, figure out what went wrong and fix it! Most bad debts we study are completely preventable...not planned risks.

You shouldn't find out *after* the sale that you couldn't afford to let a customer buy on credit. You need to effectively manage the receivables asset now to prevent YOUR own million-dollar mistake.

***For more information on preventing costly credit mistakes e-mail us at [info@tcd.com](mailto:info@tcd.com) or phone us at 800-451-0164.***

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