Credit Management vs. Collections

EXECUTIVE SUMMARY

Conceptually, collection is the easier of the two to understand. That is not meant to belittle the work done by collectors, nor is it meant to downplay the difficulty in collecting money successfully. Making a collection call is hard work, particularly when trying to be professional in the face of an unpleasant or angry response. On the other hand, credit management is sometimes, perhaps often, misunderstood. Many believe the two to be one and the same, when, in fact, they are quite distinct.

Tom Gannon, CCE
Director of Research & Education
Federation of Credit and Financial Professionals

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and FINANCIAL PROFESSIONALS

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Many believe the two to be one and the same, when, in fact, they are quite distinct. There is also a serious difference between collecting from consumers and doing the same with businesses. For one thing, an unhappy consumer is more likely to continue to use a given credit card, for convenience or because access to other cards may be limited. There is also the constant pressure to buy, and then buy more, of a favorite brand, not to mention the fear of a poor credit score. Automated call centers and scripts are the rule, rather than the exception, in consumer collections these days. Getting the money is the goal, and that is it.

Before discussing the true distinctiveness of trade credit management vs. collections, it is also appropriate to understand the differences between consumer and commercial collections. As mentioned, call center and script automation are the hallmarks of consumer collections. Given the usual delay between the consumer saying "hello" and the collector actually picking up from the auto-dialer, the consumer is already on edge and probably annoyed. The lack of a caller ID or the use of a fake one adds to the potential frustration, even before the first words of the script are read. The true reasons for the delinquency are unimportant to the caller, and their automatic replies, again read from a screen or "flash cards", are annoying at least.

The commercial collection process must be different. Why? The trade creditor is counting on repeat business from the overdue customer, for one. Usually, the collection activity itself is coming from that credit granting business itself, rather than a third-party collection agency. Every aspect of that collection activity is a direct reflection on the credit grantor; its products, services and other representatives, as in the sales associate trying to solicit another purchase. Successful commercial collection activity must always keep this in mind, since many businesses will still attract repeat purchases from delinquent customers, even if on a cash basis. Yours truly has actually had experience with such cash purchases, even secured credit purchases, by seriously delinquent customers, as the principals of those businesses are in court, as part of lawsuits to collect past due balances.

Therefore, as an assigned commercial credit associate/ collector does his/ her job, he or she should:

1. Know the customer. Be aware of the importance of that customer to the creditor.
2. Be aware of any past collection activities and the respective results. Was a payment promised and then missed? Was the reason for the delinquency valid?
3. Was the problem a one-time issue or a trend? Anyone can make a mistake, even, occasionally, more than one. However, negative trends can be critical.
4. The format of a trade collection call should be: Talk, stop and listen, then talk again. In other words, the caller should identify himself or herself, then give the reason for the call.

Allow the customer to reply. Based on that reply, follow up with either additional information or the next step in the process.

5. Carefully note the content of the call, including the reasons for the delinquency.
6. Be prepared to correct issues that may be caused by the seller, rather than the buyer. Make the appropriate person or department aware of the issue and arrange for follow-up, to ensure that it is corrected and that the customer knows it.
7. Allow an appropriate length of time for a promised payment to arrive, and then add a follow-up date. To keep the customer "honest", be sure to follow up on time.
8. For customers with regular follow-up needs, get to know the various contacts on their end. Besides making the next call more efficient, it will tend to ease any stress on the part of everyone involved.
9. The ideal outcome in this purely collection-oriented environment is that the money is collected, an immediate bad debt risk does not exist, AND one has a customer still wishing to buy.

Credit management, in its truest sense, is much more involved. First, and probably most importantly, it requires a certain aptitude. Abstract thinking and the ability to consider multiple points of view and multiple facts simultaneously are equally critical. It is not always just about the amount owed vs. a credit limit number on the screen. The same goes for any amounts past due vs. the total balance. Those items are important, yes, but one must also consider industry trends, a customer's place within that industry and their importance to one's own company. One must be able to balance these issues within the context of many other facts and concerns.

The second most important aspect is the level of a credit manager's knowledge. Even certain industries require different degrees of knowledge. For instance, in addition to the standard more well-known credit laws, such as the Equal Credit Opportunity Act and the Fair Credit Reporting Act, there are a multitude of other legal issues that, depending on one's industry, may impact everyday life as a credit professional to varying degrees. For instance:

1. The Uniform Commercial Code, based on English Common Law, is the basis for conducting business in this country. However, some do not realize that it is sometimes at the whim of individual states to enact all or parts of it. An example is the fact that some states have repealed Article 6: The Fraudulent Conveyances Act, otherwise known as the Bulk Sales Act. For decades, Louisiana state law was based on the Napoleonic Code, based on its French lineage, rather than English Common Law. That has since changed.
2. For those in the construction industry, there are 51 distinctly different laws governing the availability and enforcement of mechanic liens, and another 51 laws dealing with payment bonds on state and local government projects. Federally funded projects have the Miller Act, so, for a national operation that is 103 laws that one's counterpart in another industry does not have to worry about.
3. Publicly held companies have to comply with the Sarbanes-Oxley Act (aka SOX), to the point that many credit departments have to sign off on the validity of the receivable. Part of that process is having documented internal controls, levels of authority and precise operating procedures. What many do not understand, though, is that some privately held

firms might also need to comply. For instance, some banks may require compliance as part of the loan covenants, or insurance companies may also do so for certain types of insurance policies (personal experience for yours truly).

4. Some credit departments are responsible for sales tax exemption compliance and other tax issues. At the very least, all credit people will have to deal with deductions for improperly billed sales tax. There are literally hundreds of statutes and regulations dealing with these issues, by state, once again, and often down to the municipal level.
5. Many people do not understand the fact that a customer improperly registering to do business in a given state, which includes the relative sales tax jurisdictions, can impact one's ability to collect, even in a competent court of law. It is just another in the long list of things that a successful credit professional should know and understand. The state and local government forms alone can be horrendous, especially when a customer refuses to accept responsibility, blaming the vendor instead. State tax audits are very painful as well.
6. Financial statements, even audited ones, do not always tell the entire story. Certain ratios can be very clear in one respect, but troubling when a customer with, for instance, a Current Ratio of less than one manages to regularly pay bills on time. What does one do, when a top customer, from a sales perspective that is, looks like a bankruptcy waiting to happen on paper?
7. Another intriguing issue is that there are a myriad of ways to say "No", by saying "Yes, if…" with a positive-sounding condition that may result in a "No" or an "OK" from the customer. The "OK" gets one a sale, while the customer's "No" may prompt additional discussion.
8. Sometimes, a credit professional may be responsible for legal issues beyond the normal "pay according to terms". Even if one does not have to actually be involved in litigation beyond paying according to terms, one may need to be aware of potential conflicts with the terms and conditions on a purchase order or customer sales agreement.
9. A properly executed credit application and sales agreement is extremely important, but it requires the knowledge of what type of business registration is involved and who can legally encumber that business. For instance, can a VP of Sales legally sign a contract? The answer is that most likely, he/ she cannot. Normally, a Vice President must be of the corporate variety, basically listed as such or something similar, such as Executive Vice Present, designated as able to encumber the corporation. What about a Limited Liability Company? General Partnership? Limited Partnerships? They are all different, and, yes, FCFP has presentation material available, as well as this type of document. (There are also always potential exceptions. For example, I, as a Director of Credit, was once designated, in writing from the Board of Directors, to act as a temporary VP, in order to act on behalf of the corporation in a specific court case. Also, typically, Credit Managers may sign a binding lien waiver, since they are very much involved in those decisions, and they are too numerous to track down the company officers for each one.)

There are other circumstances besides those listed above, but this does paint a certain picture. Part of that picture is the fact that all of it can change from company to company, credit policy to credit policy. It may also change geographically within the same organization, based on regional economies and other factors. Specific industries have their own unique situations. For instance, selling to retail consumer goods stores, especially clothing, may mean that one must deal with seasonal or style changes and the resulting rise in deductions. The construction industry can involve difficult specific job issues that can cause problems collecting money from one's customer, while same customer handles other jobs in a prompt manner. Consumer electronics and appliances can force one to deal with warranty issues. In that case, how does a distributor, who makes nothing and installs nothing, deal with a customer refusing to pay on that basis? What about liability issues, if a consumer is injured or worse, and there is a lawsuit against that distributor? Patent infringements? There are defenses for all of these situations, including the wording in a credit application.

Once again, to cover each contingency in a single article like this is impractical. The purpose here is to draw attention to the concept that credit management, while involving the need to collect money, is a truly complex field, requiring education and the ability to draw that education into multiple decision-making scenarios in a given day. Mitigating the potential for a bad debt is much different from eliminating the possibility of one altogether. The latter choice may cost a company significant revenue opportunity. The former can be accomplished to varying degrees of success, with the understanding that there is still the potential for some losses. The key is having the training and the ability to make reasonable business credit decisions, within a total pool of circumstances, company needs and the various alternative options to add some security, such as Standby Letters of Credit, Purchase Money Security Interests, UCC-1s and more. THAT is what makes the business credit management profession so interesting…and challenging!

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Federation of Credit and Financial Professionals
51 Cragwood Road, Suite 200
South Plainfield, NJ 07080
www.federationofcredit.com