THE KEYS TO SMART (AND PROFITABLE) BUSINESS CREDIT MANAGEMENT

A credit management program, featuring effective business evaluation, ongoing customer and vendor management, and information resources, can be a lever for future growth.
INTRODUCTION

Savvy, growth-oriented businesses understand that proper credit management and monitoring systems yield a wealth of information to help company owners evaluate risk and spot opportunities, thus keeping a business protected and profitable. The best credit management solutions offer comprehensive collections of evaluation tools that can help level the playing field for businesses of any size.

As growing companies focus on closing sales and offering payment terms, it becomes even more critical for them to establish an effective credit management system, say small business consultants Doug and Polly White, founders of Whitestone Partners, a small business management consultancy in Midlothian, Virginia. All too often, the prospect of landing a big customer makes them balk at anything that might be considered a roadblock to making the sale. However, says Doug, making a sale to a customer that doesn’t pay its bills on time—or at all—can cause extreme financial damage to any business.

“If you let people buy products or services on credit, you are essentially lending money. If that money is not paid back, you could find yourself in a place where you can’t pay your rent or cover payroll, and then you’re damaging your own business credit,” he adds.

In addition to the benefit of mitigating credit risk, a comprehensive credit management program also provides businesses with information about suppliers and can uncover key sales opportunities. The foundation of an effective credit management program which yields practical and profitable results lies in three key areas: Effective business evaluation, ongoing customer and vendor management, and building information resources for future growth.
Despite their value and potential to help small businesses, credit management and monitoring tools are often not used in the best possible manner, to many companies’ detriment, says Charles H. Green, executive director of The Small Business Finance Institute, an Atlanta-based provider of affordable education, instruction, and mentorship about finance.

In a 2010 report, the National Federation of Independent Business (NFIB), a leading business advocacy group, found that 40 percent of small business owners who extend credit have as much as one-third of their receivables more than 60 days delinquent. Another 8 percent have between one-third and two-thirds of their receivables more than 60 days delinquent.

“There are practical reasons why you would have an account that allows some flexibility in payment or other terms, such as convenience or industry norms. But you want to have some guidelines. You don’t want every client with their own deal or their own understanding of the terms you’re willing to provide,” says Green. “And you have to know what kind of risk you’re taking on.”

The more any business knows about its prospects, customers, and vendors, the better their decisions about granting credit will be. Reviewing and monitoring credit profiles can give you essential pieces of information about the companies with which you’re doing business, aggregating information that operators need to assess, such as:

The more any business knows about its prospects, customers, and vendors, the better their decisions about granting credit will be. Reviewing and monitoring credit profiles can give you essential pieces of information about the companies with which you’re doing business.
• **The business and its management team.** Understanding the business, its history, and the people who run it is one of the first steps in evaluating a company, says Polly White. Strong management teams and successful track records are indicators that the business is a good credit risk. Startups that are well-funded or which are launched by experienced entrepreneurs may also be safer bets because of the depth of talent and experience. Newer businesses that are run by inexperienced teams may need to prove themselves by building business credit profiles before they are granted credit terms, depending on the industry.

• **Past and current financial and payment performance.** A very strong indicator of risk is the company's payment performance, says Green. A long history of on-time payments made on credit lines of similar amounts indicates that the company takes its credit obligations seriously. Credit profiles can yield a wealth of information about payment practices, says Doug White. Companies that routinely carry high balances may be riskier, even if they have good payment records, simply because they are over-leveraged. A spate of late payments in the past may indicate a short-term cash crunch and not be cause for concern. A pattern of late payments on accounts that are now closed or which were referred to collection agencies and were subsequently replaced with new lines of credit, or a recent rash of new credit line reporting may indicate that the business is having financial difficulties and trying to finance its way out of them, he adds.

• **Public records, liens, and collection.** A company's business credit profile will also aggregate information from public records, including judgments from lawsuits, including those resulting from collection activity, tax obligations, or civil matters; liens placed on the business or its assets by creditors; bankruptcies and foreclosures; or other legal action. These tend to be more serious in nature and may indicate a serious credit risk, says Green. At the very least, the prospective customer or supplier should be prepared to explain them to give you a better understanding of the circumstances.

• **Overall community rating.** While it’s not based on carefully crafted financial models, a business's reputation among peers, customers, and other members of its community is also useful for understanding its creditworthiness. If a
company has avoided honoring its financial commitments, it’s likely that people are speaking out about it online. A credit profile that provides insight into the business’ online reputation as seen through others can help complete the risk picture and help a prospective creditor decide the best terms and credit limits.

ONGOING CUSTOMER AND VENDOR MANAGEMENT

Once approved, many businesses never give another thought to their clients’ credit lines until payments slow or cease altogether, says Marc Neeb, president of the Association of Credit and Collection Professionals, also known as ACA International, a Minneapolis, Minnesota-based trade association.

Ongoing monitoring of credit profiles is another element of good credit management. Keeping tabs on customer and even vendor performance over the long term can help an operator ensure that their accounts remain in good standing, and can be a critical part of growing a business. For example, if a specific customer’s business performance continually improves, it offers an excellent opportunity for up-selling. Conversely, if a customer or vendor’s business is in a downturn, ongoing monitoring gives an operator the opportunity to be proactive in ensuring that bills are paid or that inventory is available when needed.

Collections are critical

Too often, good businesses are not as skilled at getting the money they are owed. Without timely collections, businesses cannot survive, says Neeb. One of his family members owns a hardwood flooring company. Even though Neeb is a collections
expert and has counseled his relative many times, the collection policies are still loosely enforced sometimes, resulting in difficult collections.

“It’s for a variety of reasons. Number one, it’s just not something they’re comfortable with. They don’t do this every day, so it feels uncomfortable asking people for money. But that’s one thing small business owners need to get past: the money is rightfully theirs. They’ve provided a service or product, they deserve to be paid, and they shouldn’t be bashful about it,” Neeb says.

A strong, consistently applied collections policy can remove some of the discomfort from the situation while providing a number of other benefits. A system-based approach to collections helps companies improve their collections ratios, improve cash flow, and even strengthen customer relationships. System components may include:

- **Timelines.** The length of time established by a company’s credit terms will vary depending on the company, industry, and other factors. Many companies adopt policies of payment of the net balance within 15 or 30 days of receipt of invoice. If the remittance is not received within 45 to 60 days, a reminder is sent. This is typically gently worded, possibly allowing for the fact that the invoice has been overlooked or that the payment and reminder simply crossed in the mail, says Neeb. If an account is 90 or more days late, it is generally considered delinquent and is often harder to collect. Therefore, if there is no response to the 60-day letter, it may be a good idea to contact the customer via phone or other means before the 90-day mark.

- **Communication.** Companies should communicate their credit policies in writing. If appropriate, they should be included in the original agreement and also on invoices. Still, there are times when good customers run into short-term cash flow crunches. In other cases, a customer may be holding off on paying an invoice because of dissatisfaction or quality or other issues with the product or service, and they may be having difficulty articulating those problems. Some change-of-address notifications may be overlooked, and companies may be
sending out invoices to wrong addresses. In any case, inviting the customer to respond to collection activities is important to find out what, exactly, is happening and to help maintain relationships with good customers. For example, if a customer is just waiting for a big check to arrive or funding to clear in order to pay the account in full, it may not be appropriate to send increasingly stern letters. Similarly, if the company is experiencing “growing pains” because of rapid expansion, employees may be having difficulty staying on top of systems and bookkeeping. That may be an indication that there is an opportunity to sell more goods or services to the company.

Keeping open communication lines with customers can help you understand the reason for collection issues and build stronger relationships with your customers.

- **Processes.** Establishing a series of if-then policies at specific time periods and assigning someone to be in charge of carrying them out—often a bookkeeper or, sometimes, the business owner—also creates a tool to give you greater leverage in collecting. If customers are informed that a company deems payments late after 30 days, cuts off new credit sales after 60 days, and refers accounts more than 90 days late to a collection agency, and that your company and the collection agency both report to business credit bureaus, they’ll be less likely to default on their obligations if they’re interested in building and maintaining good credit profiles, says Neeb. It’s also a good idea to continually monitor customer credit profiles to spot emerging collection issues.

Strong collection systems will also save time and money spent on overall collection efforts, since companies can schedule certain times when issuing invoices, follow-up letters, and other communication, creating an orderly approach to getting money in-house. In addition, the use of a collection agency or attorney to address accounts that are more than 90 days overdue offloads increasingly time-consuming efforts to collect delinquent monies. It’s also a good idea to work with an attorney to establish collection policies to ensure that they abide by any laws that are relevant to your industry or your state.
Neeb admits that, sometimes, companies can lose sales because of vigilant collection policies. Yet, he also points out that companies who balk at paying their bills on time or at all are not the best customers to have.

**LOOKING TO THE FUTURE**

*As a company grows, the number and size of credit lines will often grow, as well.*

This makes credit management more important, and companies can take steps to strengthen their programs. Some areas include:

- **Policy/scorecard development.** Over time, companies will learn about their own risk tolerance and the amount of credit they are willing to extend. This is often determined through a combination of experience and objective, analytical tools that provide information about payment patterns. Business credit profiles play an important role in developing such policies and “scorecards,” giving businesses insight into the likelihood that a prospective customer is a good risk. Tools that allow businesses to develop automated scorecards that evaluate past payment history, analyze current lines of credit, and alert business owners and credit managers to possible red flags such as spotty payment history, collection actions, or judgments, can also save time and money in the long run, and allow for faster, more accurate credit decisions.

- **Fraud prevention.** Growing businesses can be targets for fraud. Using information and monitoring tools that allow businesses to spot red flags—histories of fly-by-night business operations or regulatory or compliance issues can often be spotted through careful credit monitoring. For large orders that may literally put a business at risk if remittance is late or nonexistent, further investigation, bank references, and other assurances may be needed.

- **Portfolio analysis.** Green is a staunch advocate of portfolio analysis on a regular basis. It’s not enough to issue credit at the beginning of the relationship and then assume that there will be no collection issues after that, he says.
“Even if someone is paying you like clockwork every month, five days early, you should still pull the credit report once a year. If someone's buying $300 per year from you, that's one thing. But if they're buying $30,000 on an open account, it's important to pull the report, and compare it to the previous year to see how it's doing. Are they growing? Are they incurring too much debt? Are there signs that this is an account that is trouble or one that might be open to more sales? Do this for all of your important customers, and it will tell you a lot about how your own business is doing,” he says.

CONCLUSION

Good credit and collection policies provide both a measure of insurance and the power of information to all businesses.

Smart business owners integrate them into the fabric of their operations, regularly monitor accounts, and use the information collected to make better decisions about sales, customer management, credit limits, and other areas, while benefitting from better cash flow, as payment is often received more regularly and with less effort.
As creditors increasingly rely on business credit profiles to make real-time decisions about credit terms, it is more important than ever for your business to build a solid credit profile with a robust history of timely payments. By integrating state-of-the-art technology and superior data, Experian's Business Information Services is an important resource in helping you build your business credit.

Experian is a leader in providing data and predictive insights for businesses, helping them mitigate risk and improve profitability. The company's business database provides comprehensive, third-party-verified information on 99.9 percent of all U.S. companies, with the industry's most extensive data on the broad spectrum of small and mid-sized businesses, including yours.

Learn more about your current profile and how to make it a forceful tool in building your business by visiting us at experian.com/INC.