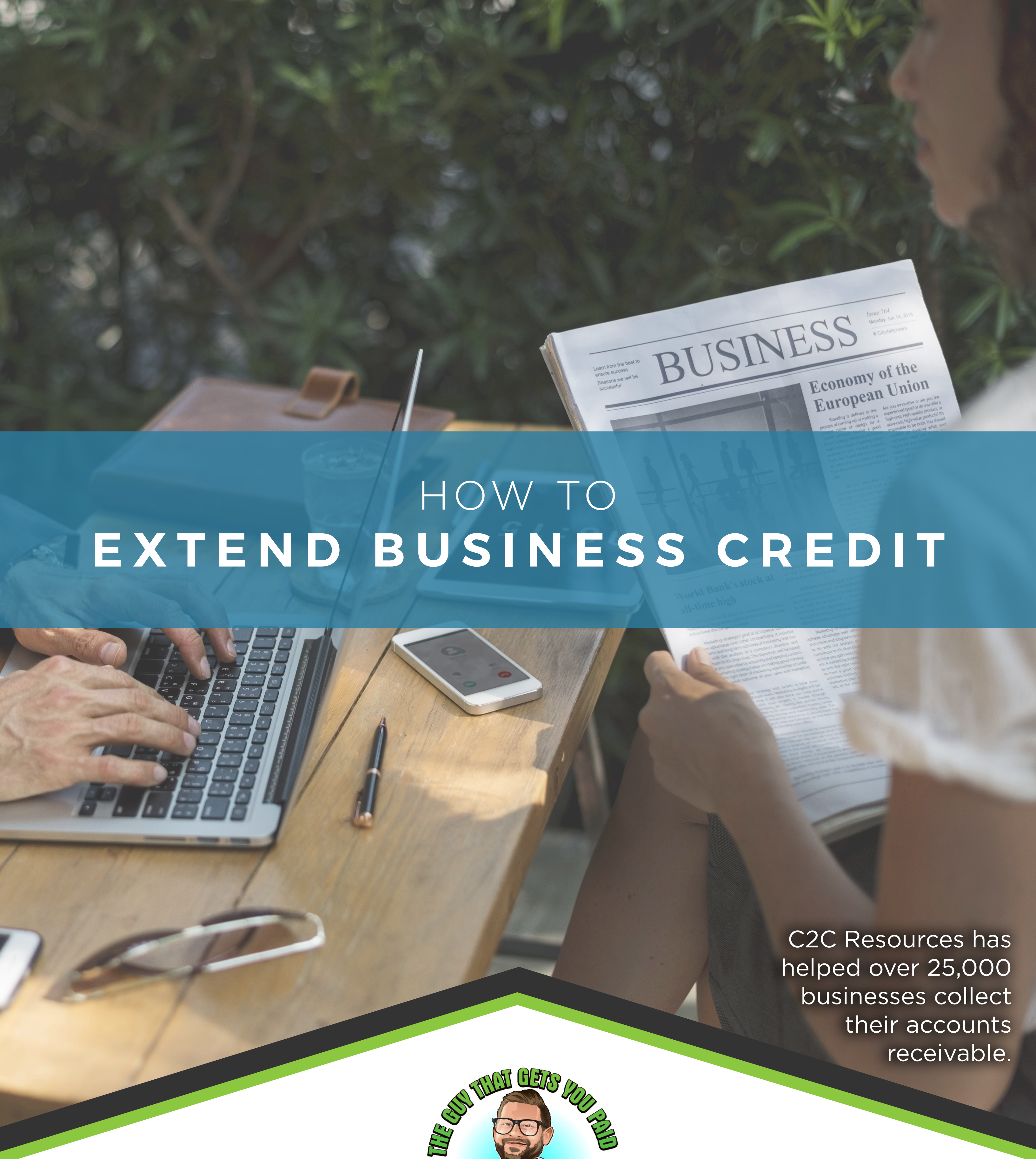

HOW TO

EXTEND BUSINESS CREDIT

C2C Resources has helped over 25,000 businesses collect their accounts receivable.

THE GUY THAT GETS YOU PAID

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How to
EXTEND BUSINESS CREDIT

Introduction:
How To Extend Business Credit

[1]**cred·it**
noun \'kre-dit\
: money that a bank or business will allow a business to use and then pay back in the future

Weighing the risks involves understanding each individual customer and his or her business or industry as well as its history.

The Latin word *credere* from which the word 'credit' is derived means to believe or trust. This definition sums up the entire credit concept in business. Any transaction made on credit between customer and supplier is a transaction made *believing* and *trusting* that goods or services purchased today on credit will be paid for in full at an agreed upon time in the future.

The extension of credit is an integral part of business. Credit is a means of creating revenue and many companies will use credit to increase sales, match or beat competitors and meet customer demands.

The business that intends to extend credit to its customers must start with a credit policy. Choosing terms, creating or adopting a credit application and creating a process by which information is gathered and validated is all part of establishing a credit process.

Weighing the risks involves understanding each individual customer and his or her business or industry as well as its history. Determining creditworthiness is a process of investigation combined with gut instinct. All the information in the world can't guarantee that a customer will turn out to be a good one. But there are indicators that can help creditors take credit risks that make sense.

Some companies establish strict policy guidelines for extending credit, while others hold to a less stringent policy. There are times when an in-depth analysis on a customer is worth the time and expense, while other customers would be better served by a streamlined process. One size certainly does not fit all.

This eBook offers a basic overall look at extending credit. We hope you'll find the information in the following pages useful as you establish your own credit policy.

Extending Business Credit: Set the Stage

THE PURPOSE OF CREDIT

There are many reasons that a business would want to extend credit. In the simplest of terms, the point is to accommodate customers in order to generate revenue. Sometimes the motivation may be very specific:

Competition
By matching or beating a competitor's credit terms, a company can stay ahead of the closest competitor.

Price
Terms of sale and the decision to grant credit can profoundly affect sales volume.

Product Demand
The demand for product or services may be hindered without the privilege of credit. In some cases, without a credit option, there would be no sale at all.

Sales Increase
Offering credit to customers can sometimes be a trade off between holding accounts receivable and holding inventory.

To Promote a Product
The offer of a special credit term is one way to boost or promote specific products or services for a limited period of time.

THE CREDIT PROCESS

In the simplest of terms, the credit process can be boiled down to five steps:

1. An order is taken for a product or service.
2. The credit manager or credit department reviews the applicant's information to determine creditworthiness through investigation and validation.
3. Once confirmed, the product is shipped based on the agreed upon credit terms.
4. An invoice is rendered to customer.
5. Customer pays within the pre-determined terms.

The extension of credit is considered part of a company's operating cycle.

Extending Business Credit: Set the Stage

THE CREDIT PROCESS *continued*

Manufacturers are a good example of how the cycle works:

> **Manufacturer purchases on credit from supplier > Material is converted into goods and sold to customer > Customer pays manufacturer > Manufacturer pays supplier.**

Determining creditworthiness can be as involved or simplified as the credit manager deems necessary. A creditor may wish to employ a full-out investigation of every nook and cranny of the new customer and his business or he may make more streamlined decisions based on the information at hand.

How does a credit manager know if the customer is going to pay when the bills are due? Is it possible to spot trouble before it happens? Who is the ideal customer? What constitutes a credit risk worth taking?

Creating a credit policy that works requires some basics: A good credit application, careful processing of the information, evaluating the customer's credit, and extending payment terms.

Once a policy is in place, the credit manager must take many factors into consideration when making the credit decision. Size of order, credit history, purchasing patterns, company size and other factors help to paint a more complete picture.

How can a creditor know which customer to trust and which one should be turned away for credit?

THE CUSTOMER

The start of any good credit relationship begins with getting to know the customer and gathering information about the business. The best time to obtain the most information about the customer is at the outset of the relationship when there's incentive to provide it.

Establishing an account for a new customer requires the name of the company and the physical address for shipping and billing purposes. From there, the credit department will want to establish a Credit File for credit applicants. At this point, the customer is provided a credit application. We'll discuss the credit app in more detail in the coming pages, but for now, let's focus on the customer.

Extending Business Credit: Set the Stage

THE CUSTOMER *continued*

You've probably heard the term, the **"5 C's of Credit".** The 5 C's encapsulates the most important aspects to examine in a customer. To set the stage, here is a brief description that we will explore more fully later in this eBook:

Character
Morally speaking, does the applicant appear to be the kind of person that will pay what is owed?

Capacity
Does it appear that the applicant has the ability to pay?

Capital
Does it appear that the applicant has financial strength measured by net worth or equity?

Collateral
Does the applicant appear to have possessions like inventory, equipment or property enough to cover an unpaid debt?

Conditions
Does it appear that current economic or industry conditions will affect your applicant favorably?

Determining the creditworthiness of an applicant is best done using the 5 C's as a guide throughout the course of investigation.

The dictionary defines creditworthiness simply as being financially sound enough to justify the extension of credit. We would add to that definition that a willingness to pay back the money owed (aka, the character of the individual) is just as critical. Of course, defining the term is the easy part.

Determining if an applicant is creditworthy requires work. Investigation and validation of the information gathered takes time. Sometimes a creditor will hit the mark. Other times the mark will be missed by a country mile leaving the creditor to wonder what facts might have been overlooked in the process. The importance of thorough investigation cannot be overstated.

The more effort given in gathering information at the beginning of a business relationship can mean less effort required to collect money later.

Now that we've set the stage, let's delve deeper into the important aspects of extending business credit.

The Credit Application

The credit application is usually the starting point and typically serves as the go-to document for information about the customer going forward. It's the primary channel for information gathering and will serve as the cornerstone of the customer's credit file. Therefore the credit application should be considered a living, breathing document that's updated as information changes and reviewed on a regular basis.

Since many circumstances can arise throughout the course of a creditor/customer relationship, the credit application needs to house all the information the creditor might need in any given situation.

The credit app should be structured to assist and support the creditor *before* credit is granted and *during* the credit relationship. This documentation is especially important if things get rocky with a customer or if faced with legal procedures.

Any potential customer who resists answering the questions on a credit application should be considered with the utmost caution. Remember the entire premise of credit: belief and trust. The credit relationship is one built on belief and the trust that the customer will pay when the bill is due. If the applicant is resistant from the very start, that's reason enough to proceed with caution.

A creditor may wish to design a credit app that is specific to the industry or adopt an existing one that meets the need. (A Credit App example can be found at the end of this ebook). Either way, the following pieces of information are basic to most credit applications.

- ***Date of application***
- ***Customer's full legal name, trade names or DBAs***
  Part of the function of a credit application is that of a legally binding contract. Therefore, the information must be correct.
- ***Addresses***
  Any and all addresses associated with the business including physical address, PO boxes, and billing and mailing addresses. Use caution if a mail drop is offered as an address. Consider it a red flag for possible fraud.
- ***Contact information***
  Email addresses, telephone numbers (landline and cell) and fax numbers.
- ***FEIN***
  Federal Tax ID numbers

The Credit Application

(Basic application information) continued

- ***Number of years in business***
  Long-time established businesses generally present less of a credit risk.

- ***Sales tax exemption***
  If this is applicable, the creditor should request a sales exemption certificate.

- ***Lease or own***
  This information is especially useful if the creditor/customer relationship deteriorates to the point of legal intervention.

- ***Legal status***
  It's important to identify the type of company to which credit is being extended. The legal status will dictate the person/s liable for debt. The three main types of companies are:

  1. *Sole proprietor*
     The owner and the business are one in the same and therefore liable for debts incurred by the business.

  2. *General partnership*
     Regardless of the number of partners in a general partnership, a creditor can approach any one of the general partners to satisfy a debt. Partnerships may include limited partners but a creditor may not approach limited partners to satisfy a debt.

  3. *Corporation*
     Operates with the rights and privileges of the laws of the state in which it operates. The corporation itself is liable; shareholders aren't liable for debts incurred by the corporation unless they sign a personal guaranty. (LLCs and S-Corps are included in our definition of "corporation".)

- ***Antecedents***
  Antecedent information is the information gathered about principals, owners, officers and members of a business entity. It is the antecedents that often determine business successes or business failures, therefore their business history will be useful to credit managers in weighing the risks of extending credit.

- ***Related ventures***
  The history of business ventures of the applicant may reveal a pattern that is helpful in weighing the credit risk. This includes the type of business and how the business ultimately ended (bankruptcy, buy-out, etc.).

The Credit Application

(Basic application information) continued

- **Bank references**
  Creditors must communicate with the applicant's bank directly. To do that, it will be important to have basic contact information available like bank name, address, loan officers name, phone numbers and email addresses. Creditors will also need the applicant's bank account number.

- **Trade references**
  It's standard to ask for trade references. It's also typical that the references provided by an applicant will be ones that are slanted in the applicant's favor. So, while this is good information to have, it's certainly not the only information upon which to make a credit decision. Trade references are just one of the many pieces of information that will help a creditor make a good decision.

Creditors often seek out fellow businesses for further credit information on shared customers. However, one must exercise prudence when doing so. Only completed transactions and only facts about those transactions relating to payment habits are acceptable to share.

It's unacceptable to talk about personal likes or dislikes or plans for interaction in the future with the applicant or to attempt to dissuade or persuade another creditor to do business with a customer. We'll cover more on the ethics and legalities of sharing credit information in the following pages.

Note that trade credit grantors are free to exchange information with other business creditors. Unlike consumer credit, it is unnecessary to gain the permission or approval of the applicant before investigating their financial history.

Sources for Credit Information

Credit is an ongoing process requiring that files be updated as circumstances change however, the bulk of the information gathering process is done at the start of the relationship when customers are most open to providing it.

Sources for information abound. Typically they are:

1. Customer-supplied information
2. Third-party information
3. Industry credit groups
4. Direct investigations

Let's look at each of these options more closely.

1. Customer-Supplied information

Most credit professionals begin with customer-supplied information starting with the credit application through direct contact with the principal.

The creditor that builds rapport and invests time in the business relationship is often the one who gets paid first.

The old adage "Out of sight – out of mind" can be fitting in the creditor/customer relationship. Frequent communication helps to keep the creditor and the invoices front and center.

New customers want to make a good impression and therefore, always put their best foot forward when requesting credit.

For the creditor, it may be tempting to extend trust quickly if a new customer is personable or forth coming. However, any information given directly by the customer will ultimately lean in the customer's favor. This is natural and to be expected.

This aspect of our human nature serves as a reminder; all information provided to a creditor must be validated. Due diligence is required in order to make a healthy and wise credit decision. Coming to conclusions too quickly can lead to unfortunate credit decisions.

Sources for Credit Information *continued*

In addition to the credit application, merchant statements can prove to be an invaluable tool for creditors.

In cases where a customer's credit card sales are a meaningful part of their business, it's a good idea to request 2-3 months worth of Merchant Statements right from the start of the business relationship.

Merchant statements can prove beneficial in instances where a customer requests an increase in credit at some point in the future. In that case, a creditor can request the most recent merchant statements to compare with the ones obtained at the beginning of the relationship.

Decreased sales should be obvious when the documents are compared side-by-side. If credit card sales have declined, further investigation is advised. Likewise, increased sales might give the creditor enough comfort to respond favorably to the request for an increase in credit.

To aid creditors in completing a thorough investigation, we have created what we call an Internal Checklist (included at the end of this eBook). It is designed to help customers methodically validate the information provided on the customer's credit application. Download the form from the C2C Resources blog: www.c2cresourcesblog.com/in-house-collection-procedures/internal-worksheet-checklist/

2.Third-Party Information

One distinct advantage of using a third-party information service is that information is gathered from a variety of sources, usually from an objective standpoint. The impartial viewpoint provided gives creditors factual information without bias.

These repositories compile exhaustive amounts of information about companies of all sizes, although they tend to have more information on larger businesses. Please note that no third party is going to have a complete source of information on a company. They will only have the information they worked to gather.

In this time of technology, where information is readily available and at our fingertips, it helps to know which information service companies offer the best, most reliable information served in a format you can easily use.

For the purpose of this eBook, we've spotlighted five of the top companies. The amount of credit being extended will determine what product best fits a company's needs.

Keep in mind, when granting a large credit amount, the information gathered from these companies would only serve as a starting point. Additional sources and independent verification would also be needed.

Sources for Credit Information *continued*

The following is a very brief description of five options for commercial credit information and financial intelligence composed from the promotional material of each company. In alphabetical order beginning with:

Cortera
Cortera describes itself this way: "Cortera is the online source for commercial credit information and financial intelligence on over 20 million businesses of every size. In 2009, Cortera created the first online community enabling everyone — from both small businesses to large organizations — to monitor, rate and exchange comments on the payment performance of virtually any business in real time. Cortera is unleashing the power of the Internet to transform the world of business credit reporting."

Dun & Bradstreet
D&B touts a long-standing reputation for enabling companies to "Decide with Confidence® for 170 years", delivering results that people can trust. Their "global commercial database contains more than 200 million business records" making D&B "the most comprehensive global database of its kind."

D&B offers a wide scope of services from fulfilling the request of a single credit report to an entire enterprise-wide solution.

With a D-U-N-S number, clients can even track a business throughout its life and history so that customers and prospects never get lost.

Experian
Experian is a global provider of insight into individuals and organizations that offers credit services, decision analytics, and marketing services.

Like the other companies listed, Experian has an extensive database of information that serves as a tool for managing credit risks. Experian's credit services "helps organizations to acquire new customers for credit products, to predict and manage credit risk, and to reduce their exposure to bad debt and fraud."

InfoUSA
A.K.A. Infogroup provides credit rating scores, types of business, ownership, nearby competitors and more. Like the others, any size or type of business can be found in their exhaustive database – even the small Mom & Pop shops found nationwide. With their new UCC and legal filing data, you can learn if a company has filed for bankruptcy or has a lien on its assets.

LexisNexis
LexisNexis touts itself as, "… a leading global provider of content-enabled workflow solutions designed specifically for professionals in the legal, risk management, corporate, government, law enforcement, accounting, and academic markets."

As a resource for information, LexisNexis provides its customers with literally billions of searchable documents.

It's easy to dig deeper into the scope of services of each company by visiting the websites or by talking to a representative from each company.

Sources for Credit Information *continued*

3. Industry Credit Groups

An industry credit group is a group of credit managers from various companies that share information about their mutual customers. Analysts and credit managers who share a common customer base can garner a more complete and factual view of a customer by pooling information.

Given the confidential nature of the information shared, credit group members operate strictly within the bounds of antitrust guidelines and in full compliance with the laws, both federal and state.

4. Direct Credit Investigations

A creditor may seek credit information directly from the potential customer or by going directly to other sources such as trade references, banks, Internet, customer website and public records:

- **Trade References**
  When contacting a trade reference the basic info that you should obtain includes length of relationship, date of last sale, balance range, any current delinquency, and payment history.

  Understanding an applicant's overall payment history may uncover revealing information on the nature and health of the business. For instance, a creditor may observe a history of slow payments. That particular piece of information may or may not be problematic, hence the reason we stress the importance of verifying all information acquired in the course of an investigation.

  Further investigation may indicate the seasonal nature of the business or perhaps a fast growing, robust company that's just trying to keep up. A habitual late-payer may simply be a business that's adopted a payment schedule that better meets their needs. While it habitually pays late, it also habitually pays in full and 'on time' according to its adopted schedule.

- **Banks**
  No matter where it lands on the creditor's list of priorities, it's on the list somewhere as bank references are a valuable and important part of the information gathering process.

  Needless to say, banks guard information and are cautious about the release of any financial information about businesses or individuals. All banks guard information, but not all banks operate under the same policies for the release of information. Policies vary from bank to bank.

  Regardless of a bank's policy, all banks are accustomed to being contacted by creditors for financial information.

  There are specific pieces of information a bank will want before it considers releasing any information to a creditor or to a creditor's bank. It's the who-what-why of the inquiry: Who are you, what do you want to know and why do you want to know it?

Sources for Credit Information *continued*

A creditor can approach a bank in a few different ways:

Present written authorization
Some banks require written authorization from the customer.

Make a direct inquiry
A creditor can contact a potential customer's bank directly. The best approach is to speak directly with the bank officer that handles the customer's business account.

Bank-to-bank inquiry
A creditor may request that his or her bank contact the customer's bank for the release of credit information.

The basic things to learn from a bank inquiry include:

- Age of the account
- Average balances
- NSF checks frequency
- Loans granted
- Payment history
- Collateral for loans

The exchange of credit information is a delicate and confidential matter requiring all parties be held to a high standard of conduct. The purpose for an inquiry must be clearly stated and exchanges of information must be limited to facts only, not personally held opinions or feelings about the customer in question.

Because of the sensitive nature and legal implications of the exchange of financial and credit information, it's recommended that credit professionals who use email as a source for sending and receiving information use encryption or some other security measure to ensure a confidential exchange.

- **Internet**
  General information, industry trends or news events that may influence an industry's health are easily found on the Internet.

  Subscriptions to trade publications, periodicals and news sources are a good way to stay on top of shifts that may drive or deplete business in a specific industry.

  For many credit professionals, an Internet search is the starting point in verifying credit application information. On the Internet, it's possible to verify the principal/s of a business, the business address, phone number and other general company information.

  There are many reputable websites that cover a variety of credit topics that also list resources especially useful for credit professionals. Specialized information can be obtained utilizing fee-based websites. These types of websites offer background checks as well as public records.

Sources for Credit Information *continued*

With so many paid and free sources available online, we offer the following list of resources merely as a starting point.

Dun & Bradstreet: www.dnb.com/us
Experian: www.experian.com
National Association of Credit Management (NACM): www.nacm.org
NACM's Business Credit Magazine: www.my.nacm.org/info/Core/Orders/category.aspx?catid=15
National Association of Secretaries of State: www.nass.org
Risk Management Association: www.rmahq.org
Uniform Commercial Code: www.law.cornell.edu/uniform/ucc.html
Black Book Online: www.blackbookonline.info
Credit Risk Monitor: www.crmz.com
U.S. Securities and Exchange Commission: www.sec.gov/edgar.shtml
Equifax Commercial Information Services: www.equifax.com/commercial
Lexis-Nexis: www.lexisnexis.com/en-us/home.page
SkyMinder: www.skyminder.com

- **Customer Website**
  In many cases, useful information can be gleaned from a company's website. Granted, a website is a snapshot of a company taken in the best possible lighting, but none-the-less, a creditor can gain insight into the business.

  "About Us" pages may offer the history of a company including information about the principals. And again, while told in favor of the company, it still may yield information a creditor will find useful. For instance, companies that provide a product line may also be unveiling further trade references to the astute creditor manager.

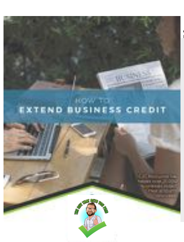
Considering today's technological advances, the absence of a website or a non-functioning site may be cause for concern. This is certainly not a deal-breaker but it is worth investigating further to see if knowledge of the customer base could shed light on why a company might choose not to have a website. Once investigated, a creditor may understand the choice and consider extending credit based on the rest of the information acquired.

- **Public Records**
  State and County Government offices store a wealth of information relevant to a creditor's research on a customer. Each state has a Secretary of State website where anyone can learn the type of business of a potential customer, the date of incorporation, names of officers and contact information.

  Legal issues like lawsuits, judgments and liens can be uncovered at the county courthouse and often online as a matter of public record. Some third party providers have aggregated this information into a central database as well.

  ...ited States Judiciary's Public Access to Court Electronic Records is known as the PACER system and

  ...users to obtain case and docket information
  ..., and the PACER Case Locator."



For more information on improving collections, visit **here** to download out complimentary eBook, **Guide to Collection Letters**.

The Ethics and Legalities of Investigating

It has long been recognized by the courts that creditors (often referred to as 'sellers') have a right to protect themselves against customers who have proven themselves untrustworthy due to fraudulent behavior or simply through a history of habitual non-payment. Uncovering fraudulent or delinquent behavior is done through the process of investigation.

Courts also recognize that customers deserve protection every bit as much as creditors.

Anti-Defamation

Truthful, historical facts alone must tell the creditor's credit experience with a customer.

Creditors must strictly adhere to offering only facts in the course of any information exchange. A creditor may have had a disastrous experience with a customer however, expressing personal opinions, attacking the customer's character, inserting passion or statements implying fraudulent business practices on the part of the customer are to be strictly avoided.

Whether in writing or in conversation, creditors must allow facts to speak for themselves. Factual data (favorable or unfavorable) stands alone, without the need for further embellishments. Disparaging remarks can lead to legal action on the part of the customer.

Anti-Trust

Be careful not to violate any anti trust laws in the effort to obtain transactional, factual information. Specifically avoid engaging in conversations that are intended to influence business transactions, coordinate pricing or terms, or to blacklist a business or persons associated with a business.

Confidentiality

Any and all information gathered by a creditor or credit department is strictly confidential. Confidentiality runs the gamut from the identity of inquirers and all other sources of information. Only with permission is it acceptable to divulge an inquirers identity.

In the exchange of credit information, there are two cardinal rules:

1. ***Keep information confidential and***
2. ***Be accurate down to the letter.***

Establishing Credit Terms: The Customer

Establishing appropriate credit terms for a customer requires knowledge about him as a businessperson and as a human being.

Knowing the customer goes back to the Five C's of Credit outlined at the beginning of this eBook: Character, capacity, capital, conditions and collateral are the starting point for understanding a customer.

Establishing credit terms also depends on the type or nature of the business. For instance, a creditor may choose to grant longer terms to a retailer who relies on sales to pay the bills. But for an industrial account that makes purchases for use as opposed to purchases for resale, the terms of the credit might be much shorter.

Character, capacity, capital, conditions and collateral are the starting point for understanding a customer.

Think of the Five C's of Credit as five separate puzzle pieces.

Character

We defined character earlier by asking the question: Morally speaking, does the applicant appear to be the kind of person that will pay what is owed?

To find out if a potential customer is the kind of person who takes financial obligations seriously and feels a moral obligation to pay what is owed can often be found in his or her business history. It's important not to make snap decisions based on face-value information. Digging deeper is often required.

An investigation may uncover a failed business venture. But does a failed business in a customer's history mean that the customer is a terrible credit risk? What if there are two failed businesses? Did the customer simply not pay the bills? Does this imply a moral failure?

On the surface, things may look grim to the creditor. But it's too soon for a character judgment at this point. Until the creditor knows exactly what caused the failed businesses, it's impossible to know how great the credit risk or the customer's character make-up.

For instance, further investigation may uncover the work of Mother Nature that left a string of destruction in her path including the businesses in question.

Consider the destruction of Hurricane Sandy in 2012. Businesses, large and small, were significantly impacted by the storm. Some closed for a few weeks, some for a few months, and some closed their doors permanently. From manufacturing to tourism, virtually no one in the affected area was left untouched.

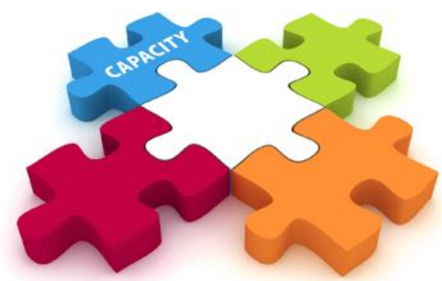
Establishing Credit Terms: The Customer *continued*

A failed business on paper does not necessarily indicate a business character flaw in the applicant. A creditor needs to know what actually happened.

In some cases, digging deeper leads to more questions than answers. In cases where a creditor's questions remain unanswered during an investigation, it is possible to obtain a *consumer* credit report on a principal of a business applying for business credit but only with their permission to do so. Written consent from the customer as well as permissible purpose will be required.

Character alone does not determine creditworthiness. It is only one piece of this puzzle. A new customer may be creditworthy as far as character goes, but that still leaves the other four C's.

Capacity



Does it appear that the applicant has the ability to pay?

When a creditor considers the capacity of a new customer, there are two main questions to answer:

1. Is this company operating profitably or have the potential to do so?

2. Is this company healthy enough to experience profitable growth?

Among the considerations when determining capacity to pay, a creditor will consider a customer's ability to maintain a positive cash flow, past payment patterns, payment history with existing or past creditors as well as other possible sources for money.

Payment history is typically found through subscription services, online resources and public records. Press releases, industry surveys, news articles or industry research data can be revealing sources for a great deal of other useful industry information that contributes to the big picture.

Is the company contracting or hiring personnel? Contracting may signal a decline in business, while hiring may suggest growth or expansion. Is the manufacturer's purchase of raw materials dropping significantly or sharply? What about their purchase of shipping services? Has it dropped? If the answer is 'Yes', there's cause for concern.

A review of the company's financial statements will help with analysis regarding capacity.

Establishing Credit Terms: The Customer *continued*

Capacity is often referred to as the primary source of repayment. Contingent sources are additional means of income that could be used to pay such as personal assets, savings or checking accounts. The point is to determine that the customer can come up with some other source to pay even if the company experiences a cash flow problem for an unforeseen reason.

To make an informed decision regarding a customer's capacity, a creditor might use a quick ratio formula by dividing the customer's liquid assets by the current liabilities. If the quick ratio is less than one (100 percent), there should be more investigation done before making a credit decision.

Inventories don't count in the equation because in cases where quick cash is needed, the company may be forced to sell the inventory below its book value.

Capital

Does it appear that the applicant has financial strength measured by net worth or equity?

Capital is measured by the company's net worth, therefore, the ideal customer is the one that is solvent or, 'in the black.'

Capital is not defined as cash but instead is defined as available wealth in any number of durable forms that help to generate wealth. It could be the inventory, machinery or buildings etc. that are used in production. For the creditor, the credit risk is lessened if the customer has an ability to repay that reaches beyond cash on hand.

If a customer's balance sheets display a declining net worth, a creditor will take note of the high risk before extending credit.

Collateral

Does the applicant appear to have possessions like inventory, equipment or property enough to cover an unpaid debt?

Expensive business assets that can be sold to pay a debt would be considered collateral. It could be property, equipment, accounts receivable, bonds, vehicles, stocks, or anything that could be seized by a creditor as payment.

Of course, it's important to find out if any of the expensive assets under consideration are already being used as collateral for an existing loan. If that is the case, they cannot be considered as a possibility for payment.

Establishing Credit Terms: The Customer *continued*

Conditions

Does it appear that current economic or industry conditions will affect your applicant favorably?

The investigation process and a good understanding of the nature of the business will bring clarity to the credit professional when trying to answer that question. And the reasons are obvious.

Some industries are subject to cycles that bring a spike in sales. Businesses that specifically market holiday or seasonal items, for instance, will thrive at peak season but may languish during the off-season. A creditor will take these things into consideration and if credit is granted, will create credit terms that make allowances for the ebbs and flows.

Some industries suffer if nature goes on a rampage, and yet others will thrive in traversing the very same natural disaster. Consider the spike in sales for many regional hardware stores when big storms hit. Conversely, a restaurant located one block away may be out of commission for days, weeks, or even months.

National headlines and news events play a critical role for many industries. Just as the stock market can rise and fall based on headlines, some industries fall victim to (or benefit from) those same news events. The national economic status, local and regional economic situations and state and federal regulations may impact certain industries, as well.

Staying 'in the know' is key for credit managers.

Establishing Credit Terms:
Specific Payment Terms

A credit policy should include payment terms that generally remain consistent over time. There may be times when special credit terms are offered as a means of generating sales or special terms offered as a reward, but the general terms overall, (once set in place and proven effective) should remain consistent.

Once terms have been established, it should always be put in writing for the customer and verbally discussed at the time of establishing an account. And in cases where a customer's payment behavior begins to slip, the creditor may wish to review the written document again with the customer as a reminder of the agreement that was made.

There are times when even a thorough investigation of a customer will leave a creditor on the fence about taking a credit risk. In such cases, it is possible to establish initial terms of sale that progress as the business relationship becomes steadfast. Options to consider include:

CODs, CBD or CWO's

For instance, a creditor might start with cash or cash on delivery (COD) as a starting point lasting six months. After a successful six months, the next phase of credit might be limited credit terms for another six months and then full credit after a year of successful payment habits.

A creditor may want to do business with a customer, but not on a credit basis due to a credit risk too great to take. Cash before delivery (CBD) or cash with order (CWO) are ways to do business with little to no risk except in cases where a check is used for payment. Customers using a company check that's uncertified still present the risk of insufficient funds.

Another option to consider is partial credit, which requires a down payment. If there's a high level of risk, the creditor may require a greater down payment.

Cash on delivery (COD) would provide another option however, a risk exists in that the customer may choose to refuse the shipment or may, at the ninth hour, be unable to pay for the shipment. The level of loss depends on the product itself.

Establishing Credit Terms:
Specific Payment Terms *continued*

Short terms: bill-to-bill and receipt of invoice

For buyers who receive regular deliveries of goods from a seller on a specific time schedule each week or each month, 'short terms' are often the terms agreed upon between the two parties.

"Short terms" means the buyer has a short period of time in which to pay the invoice before the next shipment arrives. Think of it like a revolving door: ship, receive, pay - ship, receive, pay.

Some creditors impose "bill-to-bill terms" also known as "drop-ship" or "drop-delivery" terms. This repeat schedule of deliveries is common for businesses like a retail store selling perishable goods or gas sold to retail service stations.

A creditor might choose 'receipt of invoice (ROI) terms' that require payment of an invoice at the time it's received. Much like bill-to-bill terms, ROI terms require the invoice be paid before the next order can be shipped. While the intent is the same as bill-to-bill, the revolving door schedule of deliveries might not be.

Credit Cards and Purchasing Debit Cards

These days, more and more businesses are using cards to make payments for business-to-business transactions. The use of credit cards and debit cards ensures quick payment to the seller however, the basic structure of the terms are different than bill-to-bill or receipt of invoice terms.

B2B credit card purchases work the same way as consumer credit cards transactions: the buyer uses the company credit card for business purchases and the financial institution pays the seller. The timing of the payment is between the financial institution and the buyer but typically occurs within a couple of days. The financial institution will extract a fee from the sales amount as payment for handling the transaction. You'll have to determine if the fee cost is worth it to offer this option.

For the creditor who intends to extend these types of buying options to its customers, it's prudent to use a Credit Card Authorization Agreement document outlining the specific requirements for the use of these terms. As with any agreement, putting the details in writing is a must.

Establishing Credit Terms:
Specific Payment Terms *continued*

Open Account Terms and Discount Terms

- **Open Account terms**
  Most open account terms are based on the date of the invoice. The creditor decides how many days (often net 30) from the date on the invoice that the customer has to pay the bill. The exact number of days depends on the industry and/or the specific customer.

  Some creditors will experiment with their terms to see what works the best. For instance, some see a danger with the "Due in 30" term in that some customers interpret that to mean, "I've got time", which gives them little motivation to pay the invoice quickly. When they weigh all the invoices sitting on their desk, they'll pick the ones that need immediate attention. Where does that leave your "Due in 30" invoice?

  Some creditors prefer "due upon receipt", however, we advise caution as this may not be competitive with others in the industry. Keep in mind; it's possible to offend the customer who sends payment at day 15 and it can be difficult to know when to begin the process of follow-up. This is often best utilized with new customers.

  We aren't suggesting that net 30 terms are in any way wrong. But creditors should give themselves permission to work with the terms until they find what works best for them and for their customers.

It has been suggested that terms that are between 14 and 21 days solicit just the right amount of urgency. Many business owners see 2 weeks as an easily attained goal, with just enough urgency to provoke action, but not so much that the customer feels they've already missed the mark.

Two weeks is not 'next month', nor is it 'past due'. Maybe it's just right?

There are many factors unique to each customer that shapes his or her payment habits. Most of those factors are not within the creditors control. But if a creditor is dissatisfied with the money flow, it may be worth experimenting with to find another option.

Flexibility is sometimes required. For instance, some customers might require what's called 'single payment terms' in an instance where the customer makes numerous purchases throughout the month. In this case, the creditor will consolidate the bills for those purchases into one invoice as opposed to sending numerous bills for each separate purchase. The buyer pays for all of the month's purchases at one time even though the purchases are scattered.

Establishing Credit Terms:

Specific Payment Terms *continued*

This would differ from bill-to-bill or ROI terms in that there is no schedule or regularity. Purchases made by this same customer one month may differ greatly the next. Yet another option within an open account credit policy is to streamline with automatic approval of credit to all new customers up to a certain dollar amount.

Automatic approval accomplishes two things: It quickly expedites small orders for new customers, and it relieves the credit department of the time and expense of performing an in depth credit investigation that may be more costly than the initial order itself.

Proceed with Caution

If choosing automatic approval, we recommend the credit manager verify the existence of the business through the Secretary of State or some other database company at the very least.

Creditors who choose this policy often do so as a good faith effort to build a long-term relationship with the new customer. As the new customer builds a solid credit history, the credit limit will be increased as needed.

While the automated system is great for customers with small orders, it's important that new customers that qualify for a higher credit limit not be lost by having their credit actually *limited* by the automatic approval. In other words, if all new customers are automatically granted credit up to, say $500, the new customer who qualifies for more credit might be lost if he's limited to $500.

The credit manager along with the sales team should be able to spot exceptions so that bigger clients can be granted a higher credit limit while still receiving prompt service.

Some creditors rely on reports from D&B or other agencies to more rapidly service new customers. Using agency ratings for first-order approval is another way to avoid in-depth investigations until such time that it becomes necessary.

It'll always come down to evaluating the situation by asking: Is this first order big enough to justify the expense of an investigation? Does it appear that future sales will be large enough to warrant a full credit analysis?

- **Discount terms**
  Discount terms means that a customer gets a discount if an invoice is paid before the due date. It can be a specific dollar amount off the total bill or a percentage of the total bill.

  For the most part, discounts are offered in percentages. For instance, 1% off the entire bill if paid within ten days. The customer may opt to stick with the net 30 terms, but will have to pay the full amount in that case.

  Creditors offer discount terms for a number of reasons. It might be to meet competitive conditions in the market or to accelerate cash flow.

As a rule, discount terms may (and often do) accelerate cash flow from customers who are already going to pay. However, we've found that discounts will not reduce delinquencies from problematic customers.

Making The Credit Decision: Evaluating The Risk

The desire for every commercial creditor is to expedite an order with reasonable belief and trust that the customer will pay the bill when it comes due.

Since so much is riding on the decision to grant or not grant credit, the creditor wants to make a determination as quickly as possible so orders can be placed and goods can be delivered in a timely fashion thus setting the cycle of sales in motion between his business and his customer's business.

In some cases, a new customer's credit risk will be a non-issue for the creditor. But most of the time, initial orders from new customers will be met with a certain level of skepticism and conservatism.

At the very beginning of a new business relationship, there are a number of initial questions to answer:

1. How much credit will be needed?
2. What is the profit margin on the goods being sold?
3. Can the customer pay?
4. Does the customer have a track record of paying?
5. Is the use of credit a substitute for a bank loan?
6. Is the customer at risk for a being slow-payer? If so, why?
7. Maybe the customer doesn't presently have the resources to pay. But does it appear that he will by the time the bill comes due?
8. What are other creditors offering this customer?

The sales staff can be of great help in estimating a new customer's requirements for credit, as they are the ones first getting to know a customer and taking an initial order. With their insight, a credit manager can then delve further to verify the information provided on the credit application. And as stated previously, the customer who is resistant to providing answers to the questions posed by a credit manager is one to consider with caution.

When information is scarce

Despite the abundant sources for information, there are times when an investigation yields less than what a credit manager has hoped for.

There are a number of reasons that information may be challenging to uncover. If a customer is nervous about his competition, he may hold back information to protect his interests, however it's usually because the company is just too new or small to have much information to share.

Anytime there's little or no historic information available, there's just cause to exercise caution. The customer who has a case of nerves over offering financial information may be comforted with a conversation assuring confidentiality. This is yet another example of the importance of investigation to get to the root of the hesitancy. A nervous customer may turn out to be a great customer. But the customer who won't divulge necessary information is one to consider cautiously.

Making The Credit Decision: Evaluating The Risk *continued*

SPOTTING THE HIGH-RISK CUSTOMER

Not every customer should be granted credit. Sometimes it's possible to spot the high risks from a mile away. Other times, you may end up doing business with a customer for a while before it becomes clear that they are a high credit risk.

In the course of doing business or prior to granting credit there are things to look for that will help you weed out the customers that may end up costing you money.

1. **Failure in one or more of The Five C's**
   Strings of broken promises unveiled by a bad track record indicate a break in character. Misleading statements should be seen as a warning sign. Always remember, credit is about faith and trust.

2. **Bankruptcy**
   Chapter 11 bankruptcies present a very high risk for the creditor. Any number of things could have lead to the bankruptcy, even something that's not the customer's fault. But no matter what lead to the circumstance, clearly the customer is in financial straits now.

3. **Balance sheets and operating statements**
   Balance sheets and operating statements that reveal a declining net worth represent high risk. Operating statements put a spotlight on declining sales and/or profits. So, while you and your customer may have started out on strong footing, the earlier you spot the decline, the more quickly you can take action.

4. **Credit reports**
   Credit reports pull back the curtain on changes in payment habits. The customer whose habits have declined presents a higher risk.

5. **Payment history**
   Spotty, shotty or outright negative history might go beyond late payments. If a customer has been known to lie or if they frequently pass NSF checks, the credit risk is extremely high.

6. **Past due accounts**
   How a customer manages cash flow directly impacts your bottom line when you extend credit. Keep records that show at a glance when an account is current or past due. This will make it easy to spot changes or patterns in payments.

7. **Unexpected occurrences**
   Keep an eye on the customer's industry or the current events that may have an impact upon it. With even a basic grasp on the types of things that influence sales, a credit professional can stay one step ahead of possible future issues.

Making The Credit Decision: Evaluating The Risk *continued*

ONGOING EVALUATIONS

The process of extending credit is an ongoing one. A number of things can trigger the need for a review. Factors change all the time: For you, for your customer, and for the industry in question. Changes in an industry or even events happening in a specific geographic location can shake things up for good or bad. In those cases, reviewing the accounts of those effected is a smart move.

Regardless of whether or not there's been an event, every active customer should be evaluated at regular intervals. However, not every customer will require the same frequency of review.

Annual reviews may be perfectly adequate for the average active customer who plods along at a steady, even pace. For such customers, consider performing the review at the same time of the receipt of the fiscal financial statements. If your customer experiences an influx of sales seasonally, it's best to avoid reviewing that customer right before the rush.

Customer's who pose a possible credit risk or place infrequent orders might be best reviewed more frequently. Semi-annually, quarterly, or at time of order placement should be adequate.

Keep in mind; the top of the line customer (or prime account) may need only minimal attention unless an event prompts a review. This will give the credit manager more time to focus reviews to those accounts that present a higher risk.

Consider the following when conducting a review:

- Approach the sales department for an estimate of the customer's current and upcoming needs as well as a projection of the customer's potential growth.
- Review the customer's payment history.
- Analyze most recent financial statements.
- Review recent trade credit reports and make a comparison with previous ones.
- Review bank information. Make necessary updates.
- Go back over all notes from communication with the customer. Are there broken promises? Conflicting information?
- Look for ownership or management changes.

Making The Credit Decision: Evaluating The Risk *continued*

Reviews are for the purposes of updating information, noting any significant changes in money flow, personnel or anything that might somehow change the customer's payment habits. Staying up to date on the customer makes the job of the credit manager easier when it's time to increase or decrease credit.

A review isn't for the sole purpose of spotting things that might negatively impact the business relationship. In fact, spotting those things that indicate improvement is every bit as important.

A credit manager may extend larger amounts of credit to the customer whose circumstances have experienced marked improvement. This is good all the way around. The customer may be able to then increase sales and profits, which leads to a bright and profitable future for both parties.

When an order exceeds the credit limit, it's important to do a review to ensure that it's reasonable to believe and trust that he will pay the increase when invoiced.

There are many important points to stress that we've outlined in this eBook. We mentioned the importance of thorough investigations, of getting all the facts before making a decision or judgment and keeping information in the strictest of confidence.

Also among these critical points is the importance of documenting your decisions, your conversations and your findings. Putting things in writing is not only important between the creditor and the customer, but documenting the interactions along the way can prove to be highly beneficial.

For the credit professional working in a credit department, being held accountable is part-and-parcel to the job. Documenting why certain choices were made can prove to be important especially if a customer fails to meet his obligations.

For the business owner who is his own credit manager and credit department, keeping good and thorough notes will help to keep track of agreements made with customers. Every conversation, every promise, every amendment to an agreement should be documented.

In the event that a case winds up in a court of law, documentation of this nature can save the day.

CONCLUSION

There's no fail-safe formula for making the credit decision. No one can accurately predict the future every time. As credit professionals, what we can do is gather and verify as much information as possible before making a decision.

With so many information sources readily available, most of the information needed is within our grasp. Keeping up with industry trends and changes, while challenging, is for the most part, easily accomplished on line or through trade publications.

There is no substitute for building great rapport with a customer. Frequent conversation and follow up can lend to longevity that spans the lifetime of the business. In the end, it's often mutual trust that's been fostered between the creditor and customer that keeps the business relationship on track. Excellent customer service helps to keep the lines of communication open – honesty and integrity is what keeps the relationship mutually beneficial.

Credit Application Example 1:
Includes Personal Guarantee: Page 1

Credit Application

Date: ______________________ Credit Limit Requested: $ ________________

Company Information

Full Legal Name ________________________________ Phone# ______________

DBA (if different) ______________________________ Fax# ______________

Address: _____________________________________ Email ______________

City ____________________________ State _______ Zip Code ____________

Website _________________________________

Type of company ☐ Corporation ☐ Proprietorship ☐ Limited Liability Company
☐ Sole Proprietor ☐ Other (specify) ______________

Federal Tax ID# or Social Security Number __________ How long in Business? ________

State where incorporated _______________ Number of employees __________

Ownership Information

Please complete the below information for all officers, partners, member and owners. Please attaché a separate sheet of paper if more space is required.

Name	Title	Ownership %	Home Address	Home Phone #

Bank Reference

Name of Bank ____

Bank Address ________________________________ Phone ______________

Contact Name ____________________________ Account # ______________

Type of Account ____________________________

Credit Application Example 1: Includes Personal Guarantee: Page 2

Trade References

Please list three significant business relationships.

Name	Address	Phone #	Contact

Mortgage Holder/Landlord Information

Do you rent or own premises that the business occupies? ________ Years at location __________

Mortgage Holder/Landlord Name __________________________ Contact Person ______________

Address: ____ Phone _________________

(1) Has the company or any officer, partner, member, or owner ever filed for bankruptcy? Yes/No (If yes attach detail)

(2) Has your company or any company that any officer, partner, member or owner been associated with as an officer, partner, member, or owner ever had credit with us before? Yes/No (If yes under what name_________________________).

By signing below, I certify that I have the authority to bind the company to this agreement, and that I agree to creditor's terms of sale of ____________, I also agree and accept that the credit limit and credit terms maybe changed or withdrawn at the sole discretion of the creditor.

The information given herein is offered as part of a request by the applicant for an extension of credit for commercial business use. The information provided is represented by the applicant to be true, correct and complete. The Applicant authorizes Creditor to investigate all credit references and other sources pertaining to our credit and financial responsibility. The undersigned authorizes its banks and trade creditors to provide Creditor with complete information for the purpose of credit evaluation. The applicant understands that all past due balances will be subject to a ____ per month finance charge. The applicant further agrees to pay _____ collection charge in the event of default if the account is placed with a collection agency or attorney.

Applicant Company Name: ____

Signature ________________________________ Title ______________________ Date ___________

Print Name ____

In consideration of any credit extended, the undersigned will personally guarantee full and prompt payment of all indebtedness of _____________________ owed to _________________. This personal guarantee shall remain in force until its revocation is received by certified mail to the address and attention of _____________________. Revocation shall not affect indebtedness incurred prior to receipt of written notice. (Kentucky residents – If Guarantor is a resident of the Commonwealth of Kentucky, this guaranty shall be limited to amounts not exceeding $________for the duration of not more than _____ years from date it is signed.)

Individual signature ____ Date _________________________

Print Name ____ Social Security Number ______________

Credit Application Example 2: No Personal Guarantee: Page 1

Credit Application

Date: ____________________ Credit Limit Requested: $ ____________________

Company Information

Full Legal Name ____________________ Phone# ____________________

DBA (if different) ____________________ Fax# ____________________

Address: ____________________ Email ____________________

City ____________________ State ________ Zip Code ____________________

Website ____________________

Type of company ☐ Corporation ☐ Proprietorship ☐ Limited Liability Company
☐ Sole Proprietor ☐ Other (specify) ____________________

Federal Tax ID# or Social Security Number ____________ How long in Business? ____________

State where incorporated ____________________ Number of employees ____________

Ownership Information

Please complete the below information for all officers, partners, member and owners. Please attaché a separate sheet of paper if more space is required.

Name	Title	Ownership %	Home Address	Home Phone #

Bank Reference

Name of Bank ____________________

Bank Address ____________________ Phone ____________________

Contact Name ____________________ Account # ____________________

Type of Account ____________________

Credit Application Example 2:
No Personal Guarantee: Page 2

Trade References

Please list three significant business relationships.

Name	Address	Phone #	Contact

Mortgage Holder/Landlord Information

Do you rent or own premises that the business occupies? ________ Years at location __________

Mortgage Holder/Landlord Name ___________________________ Contact Person ______________

Address: ____ Phone ________________

(1) Has the company or any officer, partner, member, or owner ever filed for bankruptcy? Yes/No (If yes attach detail)

(2) Has your company or any company that any officer, partner, member or owner been associated with as an officer, partner, member, or owner ever had credit with us before? Yes/No (If yes under what name__________________________).

By signing below, I certify that I have the authority to bind the company to this agreement, and that I agree to creditor's terms of sale of ____________. I also agree and accept that the credit limit and credit terms maybe changed or withdrawn at the sole discretion of the creditor.

The information given herein is offered as part of a request by the applicant for an extension of credit for commercial business use. The information provided is represented by the applicant to be true, correct and complete. The Applicant authorizes Creditor to investigate all credit references and other sources pertaining to our credit and financial responsibility. The undersigned authorizes its banks and trade creditors to provide Creditor with complete information for the purpose of credit evaluation. The applicant understands that all past due balances will be subject to a _____ per month finance charge. The applicant further agrees to pay ______ collection charge in the event of default if the account is placed with a collection agency or attorney.

Applicant Company Name: ____

Signature ___________________________________ Title _________________________ Date ____________

Print Name ____

Internal Worksheet Checklist: Page 1

Internal Worksheet Checklist for Credit Application

Investigated by: ____________________ Date: ____________________

Using debtors latest credit application, confirm the following:

- ☐ Confirm legal entity
- ☐ Verify business name
- ☐ Verify address
- ☐ Verify phone
- ☐ Verify contact name and title

Verification sources: ______________________________

Bank information – Confirm the following:

- ☐ Name of bank
- ☐ Address
- ☐ Phone
- ☐ Contact name
- ☐ Account number

How long has the account been open? ______________________
Average balance ____________ NSF frequency ____________
Loan balances ______________________
Any current delinquency? ☐ Yes ☐ No
Payment history: ☐ Current ☐ 0-30 ☐ 30+
Collateral for Loans ______________________

Verification Sources: ______________________________

Mortgage Holder/Landlord Information – Confirm the following:

Does the customer rent or own the business property? ☐ Rent How long? _____
☐ Own

- ☐ Verify name of mortgage holder/landlord
- ☐ Name of contact
- ☐ Phone

Is rent or mortgage paid timely? ☐ Yes ☐ No
Verification sources: ______________________________

Internal Worksheet Checklist: Page 2

Trade References

- ☐ Business name ______________________________
- ☐ Name of contact ______________________________
- ☐ Years doing business ______________________________
- ☐ Balance range ______________________________
- ☐ Date of last sale ______________________________

Any current delinquency? ☐ Yes ☐ No

Payment history: ☐ Current ☐ 30-60 ☐ 60-90 ☐ 90+

Comments:

____

____

Trade References

- ☐ Business name ______________________________
- ☐ Name of contact ______________________________
- ☐ Years doing business ______________________________
- ☐ Balance range ______________________________
- ☐ Date of last sale ______________________________

Any current delinquency? ☐ Yes ☐ No

Payment history: ☐ Current ☐ 30-60 ☐ 60-90 ☐ 90+

Comments:

____

____

Trade References

- ☐ Business name ______________________________
- ☐ Name of contact ______________________________
- ☐ Years doing business ______________________________
- ☐ Balance range ______________________________
- ☐ Date of last sale ______________________________

Any current delinquency? ☐ Yes ☐ No

Payment history: ☐ Current ☐ 30-60 ☐ 60-90 ☐ 90+

Comments:

____

____

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