

LET'S GIVE CREDIT WHERE CREDIT IS DUE

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Most businesses extend credit in some fashion to their customers. Unfortunately, the problems generated by poor credit granting practices have toppled both small and large organizations. The best single way of keeping receivables and cash flow steady is to pay special attention to how credit is extended in the first place.

In a perfect world, any credit decision would be made only after a potential customer has provided a credit application fee and you have reviewed:

1. A signed credit application which includes financial information, bank and trade credit or references, acknowledgment of your credit terms, personal guarantees from a corporation's principals, an agreement to pay your complete costs in case of customer default and the consent to talk to the references and disclose the customer's credit history with you;
2. A credit report from a reputable credit reporting agency. This will disclose unpaid accounts, judgments and the creditor's payment history;
3. A Personal Property Registry Search. This will disclose unpaid judgments, banks and other secured creditors and whether the customer has recently undergone re-financing.

Always call the trade references (especially the trade creditors). While you know the customer is providing the best references, ask whether the customer is a regular or periodic purchaser, the volumes, does the customer have a credit limit and how fast does the customer pay.

Make sure you ask the customer if the products or services you sell, have been purchased in the past and if so, who they were bought from. With the customer's permission, check the same credit information with this supplier as with the references provided.

You can now make a more informed decision on whether or not to grant credit. If so, clearly establish a credit limit and make it conditional upon the customer providing adequate security for that amount. A standard form Security Agreement tailored to your industry can be prepared and utilized as part of your credit package. Once properly registered (\$10.00 for one year plus \$5.00 per year thereafter) you will gain the extra protection of being able to seize assets and increase your chances of collection in the event the customer goes bankrupt. A caution, get good advice before acting on a Security Agreement. For instance, the procedures to seize a farm implement are mandated by statute. Failing to follow these procedures will expose you to a penalty of one and a half times the implements value.

But what if the world is not perfect? Many times, your credit policies are driven by what your competition is doing. By demanding security, or even the signed credit application you risking send the customer across the street. Or perhaps you view the amount of the credit as not warranting the expense of an investigation.

In the first case there are always some steps you can take without the customer's consent or acknowledge. Credit Bureau and Personal Property Registry searches are examples; their costs are minimal (about \$30.00 per customer for both). If you set up accounts with the appropriate agencies you can generally have the reports faxed to you the same day.

If you cannot get the customer to pay a credit application fee and do not wish to incur the

costs of these checks that is a business decision which will increase the risk of bad debt. Legal or collection fees are sure to be higher. To test whether the costs is worthwhile, multiply last year's new customers by the cost of the investigation you would like to employ. This will show how many of your bad debts, at your variable costs, you have to deny to save money. You will never eliminate bad debts. The secret is to get the ratio as low as possible.

If you cannot get a credit application you should get, at a minimum, a signed credit agreement. Collecting interest on overdue account at more then the moderate by government regulations in only possible if the customer has agreed in writing to do so. Similarly, obliging the customer to pay your reasonable collection costs is enforceable only if it is agreed to in writing. Other simple but useful matters as such as the manner in which notices can be sent or served should be included. Usually anyone unwilling to agree in writing to your credit terms does not intend to honor them.

In my view, the best credit policy is your reputation. Your customers will know whether you are known for aggressively pursuing collection of accounts or are an easy mark. Do not view each account in isolation. See your bad debts as a portfolio and base your expectation of realization on a percentage of the total group. In this way, the total failure of one particular account will not be so discouraging. It will be balanced against the successes on another. This strategy will allow you to treat all bad accounts in the same fashion and send a clear message to your customers, and more importantly, potential customers: that you will not tolerate non-payment of your credit.

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