Coming to collect

How a good credit policy can help you minimize your credit exposure

Interviewed by Matt McClellan

There is not one single credit policy that will be perfect for each and every company. But, a well thought-out credit policy can help weigh the risks of a customer defaulting and determine whether their business is a risk worth taking.

A company looking to expand its market share may decide to extend credit to just about anyone, besides, of course, obvious bad debts. On the other hand, a company with a more mature and established market position might not be interested in taking any risks at all, and may choose to only extend credit to customers that are completely creditworthy.

"Receivables are a big part of a company and write-offs hurt," says Dan Bennett, an associate with Kegler, Brown, Hill & Ritter. "So it's important to have a handle on the quality of your receivables."

Smart Business spoke with Bennett about how the collection process works and how tweaking your credit policy can help you with it.

Dan Bennett
Associate
Kegler, Brown, Hill & Ritter

What are some common mistakes companies make in their credit policies?

From a legal perspective, one of the biggest mistakes companies make is not knowing their customers. Literally, you have to know exactly who your customer is. The customer may use a trade name, or it could be an individual and not an entity. Once a matter hits my desk and the client wants to proceed to suit, if I have to spend time researching what entity actually owes the debt, the entire collection process becomes much more difficult, expensive and uncertain. The worst cases I've seen are where the customer doesn't actually exist from a legal perspective — in other words, the entity listed on the credit application is not an actual registered entity.

Another mistake is not maintaining the file properly. This might sound basic, but if a client wants to proceed against a debtor under its standard contract or a personal guaranty, I need to have a fully executed copy. If the creditor is secured and wants to take advantage of its remedies as a secured creditor, I need a signed Security Agreement and the security interest needs to be perfected.

From a business standpoint, the biggest mistake I see is continuing to extend credit when there are red flags associated with the account. An ounce of prevention is better than a pound of cure, and so if an institution is looking to minimize credit risk, the credit managers need to be proactive any time there is a warning sign on the account.

How does the collection process work?

Assuming we've done our homework on the debtor and we think collection efforts make sense, we'll either send out a demand letter or proceed directly to suit. The claims we'll bring and the entities we sue will depend on the facts of each case. Is the creditor secured? Does the creditor have a mortgage? Is the debt personally guaranteed? Were sales made pursuant to a contract or on an open account? Has the debtor been doing anything nefarious that might make claims against shareholders or affiliates viable? Is the debtor the type of business where we could seek to have a receiver appointed?

Once a complaint is filed, and assuming we're unable to work out a settlement, the case proceeds to judgment and then post-judgment collection remedies. We'll continue to attempt to collect until the judgment has been fully paid, we're unable to identify assets to collect on, or the debtor files bankruptcy.

How long does the litigation process take?

It varies greatly. It could last a bit more than a month if the debtor fails to even defend the case. If a debtor defends the litigation all the way through trial — which would be rare, almost all collections cases end without a full-blown trial — it could last between a year and a year-and-a-half. After obtaining a judgment, forcible collection could last anywhere from a couple of months to indefinitely. It just depends on the financial health of the judgment-debtor.

Are there any solutions when the debtor has no assets?

No. You can't get blood from a turnip. Post-judgment collection results are going to mirror the quality of the credit decision the client made in the first place. When a client comes in to us with a potential new case, the first thing we do is gather all the information we can on the debtor to determine the likelihood of collection. If, for example, we see there are four judgments already outstanding, a federal tax lien, no assets to speak of, and a home in foreclosure, the reality is we're never going to see a dime from that debtor. We'll advise the client not to proceed — there's no sense in throwing good money after bad.

A company should know in advance based on how it's structured its credit policy whether it will experience a high volume or low volume of write-offs. If it's not matching up with their expectations, they need to revisit their credit policy. <<

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