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SEPTEMBER 2019

"Is Your Organization Recession Ready?"

By: David Balovich

There has been talk and market activity has been reacting to the recent news reports that we are moving towards a recession. Recessions are not uncommon, they are cyclical and usually occur every four to five years when consumer spending declines, unemployment increases, and the Federal Reserve adjusts the bank borrowing rate. Although it has been eleven years since the last recession there is no indication we are heading towards a recession other than speculation on the part of media and certain political organizations.

Few industries or countries today can claim to be recession proof, but credit and collection departments in any industry can claim to be recession ready. These organizations have established credit guidelines and are executing the necessary procedures to ensure those guidelines are not simply words in a binder gathering dust sitting on a shelf. Successful credit departments have a clear advantage in recessive times because they have the ability to identify the impact to their operations quicker and make the necessary operational adjustments that minimize risk and maximize the profitability of their receivables. In addition their guidelines have incorporated the tools available to minimize risk and under what circumstances they should be implemented.

In most businesses there are seven steps within the process of creating revenue. These include: obtaining the sale; order processing; credit approval; customer billing; collections; dispute resolution; and cash application.

Experience has shown that few organizations can say with confidence that all of these seven steps consistently operate at optimum levels of efficiency and effectiveness. The credit and collection department, including dispute resolution, can operate for long periods of time without notice from senior management. This lack of attention generally occurs during strong economic periods, where management is focused on increasing new product development, market share, and geographic expansion along with other strategic opportunities.

It is usually not until an economic downturn / recession, that management focuses their attention on the three important and most over-looked areas within the organization; credit, collections, and dispute resolution. Unfortunately, often too late, they discover the bad habits the organization has perpetuated in the areas of credit evaluation, risk management and collection strategy will take time to establish and correct resulting in delayed customer payments, increased reserves for doubtful accounts, and possibly large bad debt write-offs.

Organizations whose operations are not affected by economic downturns, and they are small in number, have credit and collection operations that consistently operate at a high level of performance and normally achieve their goals on a regular basis. This is usually attributed to their having established guidelines to achieve best practices and ensure consistent optimum performance regardless of the economic climate.

Credit and collection operations that have clear and concise guidelines that have been approved at the executive level perform better than those organizations whose "policies" have been created at the division or department level. The reason being that although business units may modify "policy" where and when necessary the overall authority for "policy" and any permanent changes lie within the executive ranks. It is much easier for the credit professional to perform within guidelines approved at the executive level rather than a credit policy that is often challenged by both the internal and external customer. Guidelines and procedures normally address the following:

Standard terms of payment – should be on the credit application, credit agreement, sales quotes, invoices, and statements.

Payment discount perimeters – Same as standard terms of payment.

Methods of payment – should be established by management and communicated to the customer at the time the account is opened and appear on invoices & statements.

Procedures for determining credit limits – should be in writing and part of the company guidelines.

Collection Process – should be in writing and part of the company guidelines.

Hold orders process - should be in writing and part of the company guidelines, should include sales participation.

Exception process - should be in writing and part of the company guidelines.

Escalation process - should be in writing and part of the company guidelines, should include sales participation.

Dispute process - should be in writing and part of the company guidelines, should include sales participation.

Account Review process – established by management - should be in writing and part of the company guidelines. This should also be an annual objective and documented in credit personnel performance review.

The potential impact of not having well documented and strictly followed guidelines and procedures can quickly compound during a declining economy creating higher levels of bad debt write – offs and increased levels of balance sheet reserves for doubtful accounts. However, simply having a documented guideline with appropriate procedures, supported and maintained by executive management, will not ensure improved measures of effectiveness. Compliance with the guidelines and procedures is paramount. For example, customer credit reviews must be completed timely in accordance with company account review requirements and necessary adjustments must be made when the review reveals they are warranted.

Successful credit professionals don't stop with having established a company credit guidelines. This best practice is augmented by a focus on tools, such as risk-scoring models, that enable timely risk analysis and assessment. The objective in utilizing models is two-fold. First, it is a key tool to determine how to conduct business with a new applicant. For example, analysis may determine the applicant be extended terms, or suggest conditional payment options such as credit card or payment in advance. Second, the scoring model functions as an early warning system for existing customers. When a risk model identifies the need for a credit review or a hold on future orders, there are several questions to be addressed before making any decision to override the warning.

The first question concerns the risk model; users should ensure the risk model is current and refined for the present market conditions. Then there is the question of alternative payment options; what affect will this have on future relations with the customer? Can a solution be reached that is mutually beneficial while minimizing risk? It is imperative the credit department have a strong working relationship with sales where cooperative discussion concerning sales strategies and revenue implications can be discussed along with risk. This degree of communication that includes, sales, credit and the customer minimizes any unpleasant surprises.

Consistent with credit review compliance is the swift enforcement of credit limit procedures when those limits have been exceeded. A healthy working relationship is created and maintained when all parties understand the criteria used in making the credit decision.

Another tool successful credit organizations utilize is the laws governing secured transactions. It has been proven time and again that secured creditors are most often paid before unsecured creditors. Successful credit organizations not only utilize these tools but also look beyond their customer for payment. Their analysis not only includes pertinent information concerning their customer but also looks at what the customer does with the merchandise; is it for use or resale. If it is for resale they look at who the end user is to assist in determining their customers' ability to pay under the approved terms they have been given.

For most companies, the sign of a slowing economy reveals itself in two areas: sales and receivables. The first indicator is often a revision of sales projections and/or an actual reduction in customer orders. While this has a direct impact on the overall size of the receivable portfolio, the real indication of recessive times is a slowing of existing customer payments. Successful organizations are quick to adjusting their collection procedures when they recognize the initial signs of a slowdown in sales which often takes one or two billing cycles to catch up to collections. Successful collection personnel recognize, even when their management doesn't, that an increase in DSO (day's sales outstanding) is an early indicator of decreasing sales rather than collections.

A credit department supported by management, with a strong sales relationship, utilizing the tools available and willing to make immediate changes when called for is recession ready. How does your organization measure up?

I wish you well.

****************************** SEPTEMBER 2019 ******************************

Day	Date	Group	Location	Time
Tues	3	Austin Construction	La Palapa Restaurant, 6640 E Hwy 290 Austin TX	11:30
Tues	10	Corpus/Victoria/La/RI	Johnny's Italian American, Corpus Christi TX/Phone Conference	2:30
Thurs	12	SW Food Credit Group	Las Palapas, 4802 Walzem Rd, San Antonio TX	11:00
Tues	17	Austin Construction	Las Palapa Restaurant, 6640 E Hwy 290 Austin TX	11:30
Thurs	19	Fuel & Lube/Heavy Eq.	Phone Conference Call Meeting	2:30
Thurs	19	HVAC Credit Group	Mechanical Reps's Office, San Antonio TX	11:30
Fri	20	SW Electrical Group	The Onion Creek Country Club, Austin TX	11:30
Tues	24	SA Construction	Las Palapas Restaurant, 4802 Walzem Rd, San Antonio TX	11:30

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