

Is The Customer Credit Worthy?

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It is sometimes said in business that a sale is not a sale until you have the money. Up until the moment you get paid for the work, your labors are, at best, a form of trust between you and your customer (and at worst, a form of charity!).

The HVAC trade is notoriously lax when it comes to extending credit to customers. Consider this: when you dine in a restaurant and use a credit card to pay for the meal, the server runs your credit card through the card scanner and a computer does a credit check on you—for a \$100 tab! But if our client has a handshake that is above room temperature, or she can fog a mirror, we will sell her a \$12,000 comfort system without doing a proper credit check! Why?

Usually, we are lucky and we are not harmed by a credit problem. But we all know that this is not always the case!

Credit Policies

A clear policy on how and when credit is extended to a customer can save you a lot of pain, anguish and money when things don't go as planned. So what should be in a credit policy?

Terms of sale should be clearly stated and printed on the proposal form. There is no one best way to do this, but here are some

possibilities:

Cash due upon completion

50% down upon acceptance, balance due upon completion

\$500 down, balance due upon completion

10% down and the balance financed through a retail credit program

Check Credit Ratings

Checking a customer's credit rating is rarely done, but it is simple to do. You should belong to a credit bureau or similar service (where such reports can be obtained very inexpensively) or you may pay a higher fee for credit reports as needed.

Some contractors like to talk to the banks as well as to other merchants to see personally how good the customer is in paying bills. This is not only inaccurate; it can also be dangerous if the customer finds out and accuses you of prying.

Most credit reporting services charge between \$10 (or less) and \$25 for a report. This fee can be built into your overhead and recovered on every sale, and is money well-spent. Just ask anyone who did not pay for a credit report first and ended up eating an \$8,000 job!

Collection Procedures

Collection procedures must be established and clearly stated. Collecting on delinquent accounts is delicate business, but you need to know your rights and exercise them. Think of it in these terms: until the money is collected, the job is an expense to your business. If you write off \$2,000 in bad debt, how much do you have to sell to make up for it? If your profit margin is 5%, about \$40,000¹!

Send invoices every day. The practice of waiting until the end of the month ties up your money and is inexcusable in this day of computerized accounting systems. Of course, in commercial plan and spec jobs where the specs detail just how billing is to be done, you are at the spec's mercy.

Determining when an account becomes delinquent should be part of the credit policy. For instance, some delinquency clauses say, "Due by the 21st of the month; delinquent after the 30th." Perhaps the best phrase is, "Due upon receipt. Past due 30 days from the date of the invoice."

So what happens when a customer goes beyond the grace period?

Let's assume you've clearly communicated your credit policy, and specified when an account becomes delinquent.

Books have been written describing elaborate collection procedures using letters and cards, but the **simplest, fastest and most economical way is to call the customer on the phone.** Mention the reason for the call and ask when you can expect payment.

¹ Since $\$40,000 \times 5\% = \$2,000$ in profit.

It may help to **offer the customer a payment plan.** If the customer agrees, make note of the plan, send a confirming letter, and follow up on it.

Be firm. Ask for specific answers to your questions, and wait for the customer to give them.

Don't say, "I need the money to pay my suppliers." *You need the money because it is yours and because the customer made a promise to pay by a certain date, a promise he has not kept.* The customer is enjoying the benefits of the job; you should too.

Remind the customer of the original terms of sale, terms agreed to when the customer signed the contract.

If the customer defaults on the plan, take stronger action. On large past-due accounts, the company's owner should make the call.

Don't hesitate to use a professional collector when you have exhausted all your efforts. Even splitting the amount with collector 50/50 is better than a 100% write-off!

Go to court as a last resort. If you threaten legal action, take it. Most states have small claims courts to settle disputes under a certain amount. Make sure you know your state's laws and procedures for small claims.

Know Your Rights!

For larger amounts, you will have to use the formal legal process. This first means protecting your lien rights. Each state has

different lien laws, specifying even the text that must be written on the proposal and invoices and the number of days in which you are allowed to file a lien.

Once your lien window closes, you are out of luck! The moral? Stay on top of your delinquent accounts and don't let the lien window close!

Normally, just filing a lien will result in payment. But if the customer still does not pay, have an attorney draft a registered letter explaining your intention to sue. Be sure to allow the customer a fair but firm response time.

Credit For Service Calls?

The trend is toward cash-on-delivery (COD). The customer should be told when the service appointment is made that the service technician will collect for the call while there and that cash, personal checks, or major credit cards are acceptable forms of payment. The preferred form of payment should be noted on the dispatch ticket.

If you have long-term service customers who have always been billed for service in the past and their payment record is flawless, there is not much to gain by changing the policy for them. You will only arouse suspicions and may lose them as customers. However, every new customer should be started as a COD account.

Cash for service is important because the amounts are usually not worth the cost to pursue legally. Also, once the customer's system is repaired and running properly, the need is met and the psychological motivation to pay is less.

One Person in Charge

In all cases of collection procedure, the **same person should be in charge each month**. This is to be sure that customers who promise to make payments per an agreed-upon plan don't slip behind and tell someone else next month that they'll agree to a different payment plan. It also helps present a unified front to the customer.

But to safeguard the happiness of the collection manager, delinquent accounts should be called **throughout the month** and not just all in one day. For example, with computerized accounting, it should be easy to print the aged receivables list each Monday morning, select one fourth of the delinquent accounts (since this report would be run four times a month), and call a few of those people every day. Since customers can sometimes become abusive during collection calls, this keeps the abuse from piling up all on one day. Most of us can take a few abusive customers each day, but not 30 or 40!

I suggest that any amount over 60 days old automatically be the responsibility of the owner, and that the collection manager brief the owner on the account's history (including payment plans and other promises made and broken) before the owner calls the customer.

The Goal

Strive to keep the average age of your accounts receivable to **under 30 days**. This may not always be possible, but it is a good goal. You can calculate the average age of your accounts receivable by dividing the accounts receivable on your balance sheet

by the sales volume for a full year and multiplying the result by 365.

Example: you have accounts receivable totaling \$80,000 with \$1,200,000 in sale;; the average age of your accounts receivable would be $80,000 \div 1,200,000$, or 0.06666, times 365, or 24.3 days.

Anything over 45 days is cause for taking strong and quick action.

Don't Wait Too Long!

The Commercial Law League of America recently produced these startling statistics about the odds of collecting past-due accounts:

Current account	98% odds of collecting all of it
1 month overdue	93% odds
2 months overdue	85% odds
3 months overdue	73% odds
6 months overdue	57% odds
9 months overdue	42% odds
1 year overdue	25% odds
2 years overdue	13% odds

Other research reveals that:

- If a customer goes beyond 60 days past

due, there is a 62% chance it will happen again.

- If a customer goes beyond 60 days a second time, the odds are 95% that he'll always pay beyond 60 days.
- Two-thirds of the accounts that get to 60 days past due will reach 90 days past due.

If you want a mild shock, take the amounts you have in the aging brackets mentioned above and multiply them by the odds of collection and then total up the amounts to see how much your accounts receivable is probably really worth.

Once you begin to look at your receivables with this in mind, chances are you'll be even more motivated to stay on top of the situation. As is always the case: Time is money!

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