

Key to Collection Is Good Credit in First Place

Eric Shaw has a motto: If you give good credit, collections will follow. Shaw, president of New York Credit Inc. in Marina del Rey, helps big and small businesses manage their credit and collections problems. In addition to helping banks liquidate troubled companies, Shaw and his 16 employees pay weekly visits to clients to act as their in-house collections department.

Collections problems stem directly from granting credit to the wrong customers. Unfortunately, many small-business owners, eager for a clientele, extend credit without fully checking out a customer's prospects. Shaw points out that extending credit puts you squarely in the role of a banker. This means that, like a banker, you should carefully check references before extending even a dollar of credit.

Here are some of Shaw's tips:

- 1 In addition to a signed credit application, require customers to sign a release form that permits their bank to provide you with necessary financial information.
- 2 Ask for at least three trade references and call the companies listed for verification.
- 3 Ask customers to provide you with copies of their last three monthly bank statements.

Study the statements to answer these questions:

- How much cash is going in and out of the business each month?
- Are there any overdraft charges on the statement?
- Does the person write any big checks close to the amount they want in credit from your firm ?

"Look at the statements to see what their cash flow is like," Shaw says.

If someone needs more than a few hundred dollars in credit, increase the information you'll need to make a prudent decision.

Next, ask for a full financial statement, including a profit-and-loss report and both year-to-date and year-end reports. If the company appears shaky, ask the owner to sign a personal guarantee for the amount of credit. Last but not least, request signed copies of personal tax returns.

Don't be surprised if customers balk at these requests. Remind them that if they want you to extend credit like their banker would, they should be willing to provide you with detailed information. If a customer refuses to give you what you need to make a solid decision, suggest that they charge their order on a credit card. This means you get your money up front and they have months to pay off the balanceto someone else.

Here's another suggestion: If a business owner has personal savings tied up in a certificate of deposit or a money market account, you might ask them to give you what's called a "domestic standby irrevocable letter of credit" linked to that account.

"It may cost \$250 for the bank to draw up a \$20,000 letter of credit, but offer to split the fee with your customer," Shaw says.

A letter of credit will definitely help you sleep at night because it means the bank will pay you what you're owed if the business owner doesn't.

If you deal with a few major customers whose demise could spell the death of your company, consider buying credit insurance. Credit insurance protects you if a customer fails to pay. Credit insurance policies are tailored to fit your company's needs, and premiums usually run about 1% of sales. Another benefit is that there's generally no deductible. In most cases, the credit insurance company pays a major percentage of your loss right away.