Myths and Facts about Credit and Collections

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A myth is a popular belief that is unsupported by facts. There are any number of myths and misconceptions about the credit and collections function, including these:

Myth: An all-out collection effort will collect almost every delinquent account.

Reality: The best time to manage risk is before orders are released and preferably before the account is ever opened. Once an order is released, the power equation shifts and the customer is largely in the driver's seat. Why? Because they have your product and "your" money.

Myth: It is both good manners and a good business practice to allow a grace period of several days before calling a customer to ask about the status of a past due balance.

Reality: Grace periods are unnecessary. There is nothing rude or inappropriate about asking a customer for payment status on any past due balance. Grace periods benefit only the debtor. Grace periods provide essentially no tangible or intangible benefits to the creditor company.

Myth: Credit departments often upset the apple cart by asking privately held companies for financial statements.

Reality: Requests of this type are received routinely even by privately held customers. The most common "reaction" to such a request is to ignore it.

Myth: Salespeople have nothing to contribute to the debt collection process.

Reality: Salespeople can sometimes bring additional pressure to bear to get a delinquent customer to open a dialogue with the credit department.

Myth: Export sales are often more trouble than they are worth.

Reality: Foreign sales can be lucrative opportunities for U.S. based companies trying to expand their sales. However, export sales often present significantly higher risk than domestic sales, and export sales require specialized skills and expertise to control the risk of slow payment or non-payment.

Myth: A company that is experiencing lower than expected bad debt losses is obviously doing a superior job of credit risk management.

Reality: This may be true – or the company may not be taking enough risk. And even if actual losses are relatively low, the company may be experiencing unacceptably slow payment from foreign customers.

Myth: If you use dunning notices, you should not also be calling debtors for payment status.

Reality: The phone remains the best and most effective way to collect past due balances. Dunning notices alone are unlikely to produce the desired collection results. Calls and dunning notices can and should be used together.

Myth: Deduction management is a great place for new hires in credit and collections to start.

Reality: Managing customer deductions is complicated. It requires strong accounting skills, excellent attention to detail, the ability to multitask and the skills necessary to convince other employees of the creditor company to take time out to respond to inquiries and requests for supporting documentation. For these reasons, deduction management is not a good position for a new member of the collection team.

Myth: If calculating ten customer financial ratios is good, then calculating twenty financial ratios is better.

Reality: Calculating too many customer financial ratios can make the credit decision more difficult. Never calculate ratios simply as an exercise. If the ratio does not provide specific insights about the risk of payment delinquency or default by the debtor, it should not be calculated.

Myth: Credit professionals need to balance the needs of their organization with the need to maintain good business relationship with customers.

Reality: True, to some extent. However, the more flexibility you demonstrate when dealing with delinquent customers, the wider you open the door to abuse of your company's payment terms.

Myth: Sales and credit are in opposition in a "zero sum game" meaning that if one wins, the other loses.

Reality: Sales and credit can work together to increase sales and profits while moderating credit risk.

Myth: The larger the balance due, the more experienced the collector should be.

Reality: Routine collections can be handled by a less experienced debt collector, meaning that more experienced credit personnel can be assigned when situations require experience, maturity, common sense and expertise.

Myth: An all-out collection effort will collect almost every delinquent accounts.

Reality: The time to manage risk is before orders are released - after the order is released the cat is out of the bag.

Myth: Creditors should allow a grace period before calling on a past due balance.

Reality: Allowing a grace period simply means that until a call is made the creditor will not know if or when payment is forthcoming.

Myth: Asking for a financial statement always upsets privately held applicants or customers.

Reality: Requesting an updated financial statement rarely upsets customers. Privately held companies may decide not to share the requested information, but requesting financial statements on accounts identified as high risk should be part of the normal risk management routine.

Myth: It is never a good idea to involve salespeople in the collection process.

Reality: Salespeople should not be allowed to negotiate payment plans, but salespeople can be used effectively to bring additional pressure to bear on the customer through the purchasing department.

Myth: All third party commercial collection agencies are created equal.

Reality: Among commercial collection agencies, collection fees and services and overall effectively varies widely. For example, some collection agencies only write letters. Other third part debt collection agencies only contact customers by phone, while others will arrange for a collector to visit the debtor in person. The method of collection and the professionalism of the agency impacts on the collection results.

Myth: Credit managers should not force debtors into involuntary bankruptcy.

Reality: Experience credit managers don't limit their options. If the likely recovery would be higher in a bankruptcy, then bankruptcy is a viable option.

Myth: Export credit sales are more trouble - and more risk - than they are worth.

Reality: For many companies, international or export sales is an area of great potential. There are tools and techniques that credit professionals can use to moderate and mitigate some of the unique risks associated with doing business with foreign customers on anything other than cash in advance terms.

Myth: Credit management is an art, not a science.

Reality: It is both art and science, and it is neither. Most of the basic skills can be mastered by anyone. However, more sophisticated risk management and negotiation skills are more of an art than a science.