

NCS INSIGHT

PROACTIVE SOLUTIONS IN A TOUGH ECONOMY

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The credit crisis has affected nearly every business segment. As a credit professional, you're feeling the pressure to meet the growing need for cash flow and profitability while having to deal with a rise in delinquencies and bankruptcies.

Although the challenges are many, so are the opportunities to dramatically improve your competitive position. That's the good news. But before we get to the action steps, consider these sobering trends:

- **Collectability is down.**
The Commercial Collection Agency Association notes in its *Third Quarter 2008 Account Placement Report* that there is a rise in account placement and dollar amount along with a decline in collectability. As a credit professional, your ongoing challenge is to help your sales department open new accounts while trying to keep a lid on steadily mounting past due accounts.
- **A long-term recession is likely.**
In a December 2008 online report, The National Bureau of Economic Research (www.nber.org) stated: "The economy will decline at least until the middle of 2009. That would make this recession the longest of the postwar era, at 18 months in length. Some think it could be even longer."
- **Bankruptcies are increasing.**
In the 12-month period ending June 30, 2008, there were 967,831 bankruptcy cases filed, according to statistics released by the Administrative Office of the U.S. Courts. This is a 28.9 percent increase compared to filings for the 12-month period ending June 30, 2007.
- **Working capital is tightening.**
In a November 2008 article titled *Managing Receivables in the Midst of Today's Economic Environment*, the Credit Research Foundation reported the results from a survey of 6,000 of its members. Seventy percent of respondents said their customers are experiencing a tightening of their working capital line by their bank. Ninety percent of respondents also reported that their customers are relying on them for working capital, which suggests that trade creditors must start thinking like bankers.

Fortunately, there is a silver lining in these grey financial times. Economic uncertainty offers many opportunities to improve your competitive position. Here are eight steps you can take right now:

1. **Re-examine** your existing credit policies.
2. Make your credit granting process **more rigorous**.
3. Ensure your operational systems and customer agreements are in place with **accurate and complete credit information**.
4. **Research and verify** your customers' legal business names.
5. If your department has been downsized and resources are limited, **contact your credit vendors** to obtain and verify credit history, credit scoring, UCC or lien searches.
6. **Prepare** Security Agreements as well as Personal and Corporate Guaranties, which are powerful tools to determine and/or minimize your risk.
7. **Talk to your trade groups** and exchange financial information on mutual customers.
8. Most importantly, **secure your collateral**.

The U.S. government provides two bodies of law to help you with securing collateral: *Article 9 – Secured Transactions of the Uniform Commercial Code (UCC)* and *The Mechanic's Lien Laws*. Who you are selling to determines which solution will put you in the best position to get paid. Here are several options to consider:

- **Article 9 provides the venue to secure personal property** such as accounts receivable, inventory, equipment, general intangibles, goods and software.
- **The UCC benefits your company when a customer defaults or files bankruptcy.** If a customer defaults on payment terms and you have a signed Security Agreement that clearly defines default, you now have a breach of contract and can use this tool to repossess your goods or sue for payment.
- **In a bankruptcy, all creditors are split into two classes: secured and unsecured.** In a Chapter 7 bankruptcy, secured creditors are paid first in the date order of the recorded financing statement. Unsecured creditors split what remains on a pro-rated basis, often receiving pennies on the dollar. The UCC filing elevates the status of your receivable to that of a secured creditor.
- **In a Chapter 11 bankruptcy, all secured creditors have the same status,** which provides them with substantial leverage over the unsecured creditors as it relates to liquidation. Now is the time to incorporate the UCC process into your credit policies.
- If you restructure past due receivables through installment notes, **be sure to secure those notes.**

Meeting the requirements of Article 9 requires you to collect information to better know and understand your new and existing customers. It is important that you:

1. Have an updated signed Credit Application.
2. Know the organization's legal name and if it is registered with the Secretary of State, as well as its corporate address and shipping locations.
3. Confirm the names of owners and officers.
4. Understand your customer's business and how it is using the products and services you provide.
5. Verify whether your customer is in a community property state. If so, it is necessary that all liable parties sign all documents.

If you don't have the time to gather this information, **get your sales team involved.** Offer a bonus to your team for accurately completed Credit Applications. And encourage them to be creative! For instance, rather than referring to the required but potentially threatening term "Security Agreement," consider calling it a "Partnership Advantage Program." Also, remember that when customers turn to you for help, whether they are requesting extended payment terms, are currently past due or are seeking a credit limit increase, you're in the perfect position to leverage this opportunity to become a secured creditor and reduce your credit risk.

If you work in the construction industry you know that construction credit has its own unique process. To ensure that you're making good credit decisions, **take the time to update customer data and review your procedures.** Start with researching your clients' corporate information. Insist that job sheets be completed for every project. Know the project address of where your materials or services are being furnished. Confirm who owns the property and who the general contractor is. You also have the opportunity to tie yourself into the trust fund of monies set aside for the project. **To do so you must consistently serve preliminary notices and file Mechanic's Liens or Bond Claims to secure your accounts receivables.** These laws were created to protect owners of construction projects and ensure that all contractors, subcontractors, and material suppliers receive the money owed them. Protect your rights and benefit from your secured interest in case your customer or someone else in the contractual chain defaults or files for bankruptcy.

Although residential construction has come to a grinding halt, commercial construction forecasts suggest modest growth through 2009. Even so, if you are concerned that a customer may file for bankruptcy, consider exchanging a carefully worded lien waiver for payment. Currently, that payment may not be considered preferential because the debtor received something in consideration for the payment. Attorneys have successfully used this argument in

defense to preference claims. **Setting up a defense by using a lien waiver is a smart move, although it doesn't provide a guarantee.**

In today's tough economy, working with a responsive, flexible debt recovery and collection agency is critical. As you spend more time each week to "put out fires," having an expert agency to react quickly when special problems arise can make a difference.

The right agency can also help you avoid collection mistakes due to misinformation. Consider this real-life scenario: A credit manager had information that he felt warranted filing suit without delay. Yet, he was reluctant to place the account with an agency because he believed that it could not be sent directly to an attorney for suit action. He mistakenly thought that an agency must first have the opportunity to collect the account before it can be placed with an attorney, when in fact *any* claim may be forwarded for immediate suit. A proactive agency partner would have responded quickly and advised him to forward the claim for immediate action. **When evaluating an agency, base your decision on its responsiveness and its level of "professionalism."** This intangible quality is comprised of intelligence, knowledge of the field, business sense, collection skills and understanding of the debtor. It makes good business sense to be certain your agency is meeting all your needs.

In this tough economy every credit professional needs a well-planned credit process. **Keep in mind that how you treat your customers today will reap great benefits tomorrow.** Take a balanced approach and try not to be too aggressive towards a good customer who has recently fallen on hard times. The economy will rebound and that customer will remember your tempered approach to their situation. After all, it is both *what* you do and *how* you do it that earns a client's loyalty. And a loyal customer is the best hedge to ensure your company's long-term health. ■