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ABSTRACT

This individualized, competency-based unit on managing customer credit and collection, the 17th of 18 modules, is on the third level of the revised Program for Acquiring Competence in Entrepreneurship (PACE). Intended for the advanced secondary and postsecondary levels and for adults wanting training or retraining, this unit, together with the other materials at this level, emphasizes the actual application of a business plan. Five competencies are dealt with in this instructional unit, including (1) analyzing the legal rights and recourse of credit grantors, (2) developing a series of credit collection reminder letters and followup activities, (3) developing various credit and collection policies, (4) preparing a credit promotional plan, and (5) discussing informational resources and systems that apply to credit and collection procedures. Materials provided include objectives, preparation information, an overview, content (with questions in margins that guide the students' reading), activities, assessment forms, and notes and sources. The unit requires using approximately three hours of class time. (YLB)

UNIT 17

PACE REVISED

Program for Acquiring Competence in Entrepreneurship

- [ ] Level 1
- [ ] Level 2
- [x] Level 3

Managing Customer Credit and Collections

Developed by M. Catherine Ashmore and Sandra G. Pritz

You will be able to:

- **Analyze the legal rights and recourse of credit grantors.**
- **Develop a series of credit collection reminder letters and follow-up activities.**
- **Develop various credit and collection policies.**
- **Prepare a credit promotion plan.**
- **Discuss informational resources and systems that apply to credit and collection procedures.**

Research & Development Series No. 240 CB 17

THE NATIONAL CENTER FOR RESEARCH IN VOCATIONAL EDUCATION
THE OHIO STATE UNIVERSITY
1960 KENNY ROAD · COLUMBUS OHIO 43210

BEFORE YOU BEGIN . . .

1. Consult the *Resource Guide* for instructions if this is your first PACE unit.

2. Read the Unit Objectives on the front cover. If you think you can meet these objectives now, consult your instructor.

3. These objectives were met at Levels 1 and 2:

   Level 1

   - Identify reasons for offering credit
   - Consider basic credit and collection policies
   - Determine guidelines for evaluating credit applicants (3 "C's" of credit)
   - Identify features of credit card plans
   - Identify basic types of direct credit plans
   - Determine how cost/benefit analysis can be conducted for direct credit and credit card plans

   Level 2

   - Identify different techniques of setting credit limits for credit customers
   - Explain what types of information you would include in a credit record for an individual customer
   - Describe how an average accounts receivable collection period can be calculated
   - Explain how the average accounts receivable collection period can be used to identify credit problems in a business
   - Identify and discuss effective internal credit collection procedures
   - Identify and discuss effective external credit collection procedures
   - Identify and discuss common attitudinal problems managers have regarding credit collections

   If you feel unsure about any of these topics, ask your instructor for materials to review them.

4. Look for these business terms as you read this unit. If you need help with their meaning, turn to the Glossary in the *Resource Guide*.

   bailment lease
   chattel mortgage
   closed-end credit
   conditional sale
   open-end credit
   secured

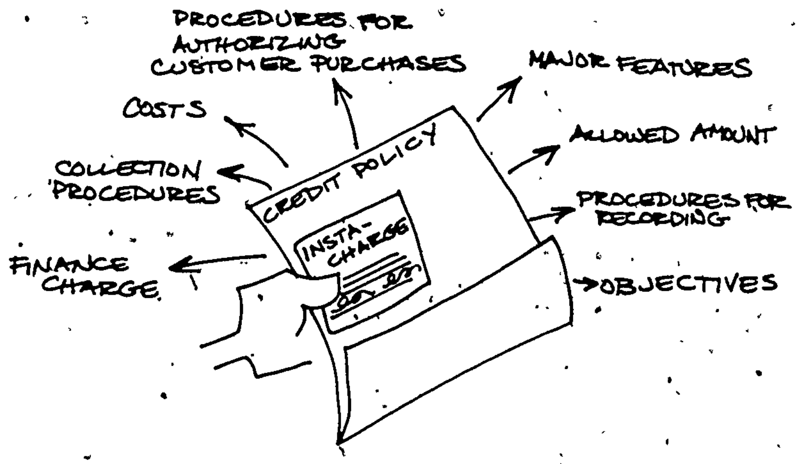
MANAGING CUSTOMER CREDIT AND COLLECTIONS

WHAT IS THIS UNIT ABOUT?

Have you ever seen an ad that read, "No money down" or "100 percent financing available" or "Thirty-six months to pay?" Such statements alone, without further information, violate the Federal Truth in Lending Act. Whenever sellers advertise that goods may be purchased on credit, they must disclose in the advertisement the exact cost of purchasing on credit.

Are you, as a prospective or present business manager, familiar with the various basic credit laws and related legal requirements and recourse of a creditor? In addition to the legal aspects of credit, are you able to analyze the pros and cons of various credit and collection policies? Can you develop an effective series of collection reminders, letters, and follow-up procedures? Are you familiar with information management resources that can assist creditors? Do you know how an effective credit promotion can be planned and implemented?

As manager of a small business you must be knowledgeable in the above credit and collection topics. You will have opportunities to apply your understanding of the information in this unit through the concluding individual, group, and case problem assignments.



WHAT ARE THE LEGAL REQUIREMENTS FOR OPEN-END AND CLOSED-END CREDIT?

There are two ways that people can buy things on credit. One way is to open an account and buy things from time to time on account (on credit). This is called *open-end credit*. Open-end credit may be obtained by opening a charge account at a particular store or by using a credit card. Open-end credit is so called because people can keep adding to the amount they owe for as long as they keep making monthly payments. Interest is computed on the amount that is owed each month.

The other way that people buy things on credit is called *closed-end credit*. This type of credit is used when someone buys one item, such as a car or a piece of furniture, and agrees to pay for it later on an installment basis, usually monthly. Closed-end credit is also involved when someone obtains a loan and agrees to repay at a later date.

WHAT MUST OPEN-END CREDIT ADVERTISING DISCLOSE?

An advertisement for open-end credit must disclose the following items:

- The time period within which the customer must pay in order to avoid a finance charge
- The method of computing the balance on which the finance charge is based
- The method of computing the amount of the finance charge, including any minimum charge
- The annual percentage rate

The proper advertising disclosure for open-end credit is as follows:

- No finance charge is incurred if payment is received within 30 days from the closing date shown on your monthly billing statement.
- If any purchase remains unpaid for 30 days from the closing date shown on the monthly billing statement, a finance charge at the periodic rate of 1-1/2 percent per month of the total past due balance is imposed.
- The annual percentage rate is 18 percent.
- The minimum monthly payment is $10.

WHAT MUST CLOSED-END CREDIT ADVERTISING DISCLOSE?

An advertisement for closed-end credit must disclose the following:

- The cash price
- The amount of down payment required or the fact that no down payment is required
- The number of payments, the amount of each payment, and the due dates or period between payments
- The annual percentage rate stated in exact terms
- The deferred payment price (that is, the total cost to the buyer)

This is a proper advertising disclosure for closed-end credit:

- The cash price is $100. There is no down payment.
- There will be twelve monthly installments of $10 each.
- The annual percentage rate will be 35 percent.
- The deferred payment price will be $120.

WHAT ARE PROVISIONS OF THE TRUTH-IN-LENDING ACT?

To protect the consumer who buys on credit, the federal government has passed a law called the Truth in Lending Act. Under this act specific rules, known as Regulation Z, must be followed by people who extend credit to others.

Regulation Z

The purpose of Regulation Z is to let consumers know the exact cost of obtaining credit. With such information, people can compare different sources of credit. They can shop around for credit and save money by obtaining it at the lowest cost. The regulation applies whenever credit is extended to people for personal, family, household, or agricultural purposes. It does *not* apply to an extension of credit of over $25,000, except in the case of real estate transactions.

Regulation Z also regulates the use of credit cards and sets limits on the amount of money people must pay when their credit cards are used without their authorization. In addition, it provides a procedure for settling disputes over billing errors on certain types of accounts.

Under Regulation Z, anyone issuing credit must disclose two things before completing the transaction: (1) the finance charge (the actual cost of the loan in dollars and cents), and (2) the annual percentage rate (the true rate of interest computed according to a special formula).

WHAT ARE THE PROVISIONS OF THE EQUAL CREDIT OPPORTUNITY ACT?

In the past, women were denied credit in situations identical to those in which men would have received it. When married couples applied for credit, the wife's income often was not considered, on the theory that she might have a child and stop working. In addition, when a husband and wife received credit, the account was usually recorded in the husband's name only; the name of the wife was not included. As a result, many married women did not have a credit history in their own name. This made it difficult for them to get credit if they were divorced or widowed. Single women also encountered problems in obtaining credit because of various credit biases and policies.

To remedy these injustices, the United States Congress passed the **Equal Credit Opportunity Act of 1975.** Under this act, creditors cannot discriminate against any person on the basis of sex or marital status in any aspect of a credit transaction. Specific rules implememting the act are found in a law known as Regulation B, issued by the Board of Governors of the Federal Reserve System.

Regulation B

Under Regulation B of the Equal Credit Opportunity Act, the following rules apply when creditors evaluate applications:

- Creditors may request and consider information about a person's spouse only when the spouse will be using or will be liable for the account or when the spouse's income is being relied upon.

- Alimony, child support, and maintenance payments must be considered as income to the extent that such payments are likely to be made consistently.

- Creditors may not discount a spouse's income because of sex or marital status nor may they discount income obtained from part-time employment.

- Creditors may not ask about applicant's birth-control practices or child-bearing plans, nor may they assume that a women will leave the labor force to have a baby.

- With certain exceptions, creditors may not close an account because of a change in marital status, unless there is evidence that the person is unwilling or unable to pay.

- Creditors may not use unfavorable information about an account a person shared with a spouse or former spouse, if the person can show that the unfavorable history does not accurately reflect his or her own willingness or ability to repay.

- When an application for credit is denied, creditors must also provide, upon request, the reasons for the denial.

WHAT ARE THE PROVISIONS OF THE FAIR CREDIT REPORTING ACT?

The **Fair Credit Reporting Act** deals with unfavorable reports issued by credit bureaus. These reports, which contain personal data, character studies, and so forth, are frequently issued to insurance companies, businesses, or prospective employers. When rejecting an applicant, the company must supply the applicant with the source of its credit report, thus giving the person the opportunity to challenge the report.

The **Fair Credit Reporting Act** also provides that the credit reporting agency must tell the individual the nature of the information that it has on file. If the information is incorrect or incomplete, a person has the right to correct the report and provide supporting information. If the report is proved to be inaccurate, the reporting agency must delete it and send deletion notices to businesses and others who have received reports containing the information. In cases of erroneous reports, the person has a right to know who received the credit record in the past *six months*. If the report was sent to companies where a person had sought employment, the person must be advised of the distribution of such incorrect information during the past *two years*.

WHAT ARE SOME OF THE SECURED VERSUS UNSECURED DEVICES?

Businesses are much more willing to extend credit if they have some assurance that they will get paid. Such assurance is known as *security*. A secured loan is one in which creditors obtain rights to something of value belonging to the borrower, from which they can recover the money if the borrower fails to pay. An unsecured loan does not have this feature.

One commonly used security device is a conditional sale, in which goods are sold with the understanding that the title remains with the seller until the purchase price is paid. Another method is a *chattel mortgage* (mortgage on personal property), in which the buyer takes title to the goods but mortgages them to the seller. A third security device is a *bailment lease*, under which the buyer rents the goods from the seller. When the amount of the rental payments made equals the purchase price, the buyer takes title to the property by paying a token amount, usually one dollar.

WHAT ARE THE RIGHTS OF THE SECURED PARTY?

If a debtor fails to pay the amount owed, the secured party has the right to repossess the goods. This repossession must be accomplished without breaching the peace (causing a disturbance). If the debtor refuses to surrender the goods, the secured party may either repossess them (with some exceptions) or sell them. The sale may be a public sale (an auction) or a private sale, so long as the terms of the sale are reasonable. If the goods are consumer goods and the debtor has paid 60 percent of the cash price or more, the secured party cannot keep the goods. They must be sold. The debtor is entitled to receive any surplus of a sale after expenses have been paid, the debt has been satisfied, and any other security interests have been paid off. The debtor is entitled to be notified of any such sale, and, in most cases, has the right to buy the goods back.

WHAT ARE SOME ILLEGAL COLLECTION PRACTICES?

The federal government and some states have laws protecting consumers against certain kinds of harassment and deceptive bill collection practices. It is a violation of the **Federal Trade Commission Act** for a creditor to use any deceptive means to collect debts or to obtain information about debtors. Creditors may not use forms, letters, or questionnaires for the purpose of collecting debts unless they state that they are for that purpose.

In 1977, the United States Congress also enacted the **Fair Debt Collection Act**. This act makes it a federal offense for debt collectors to threaten consumers with violence, use obscene language, or contact consumers by telephone at inconvenient times or places in an effort to collect a debt. Other parts of the law prohibit debt collectors from impersonating government officials or attorneys, obtaining information under false pretenses, or collecting more than is legally owed.

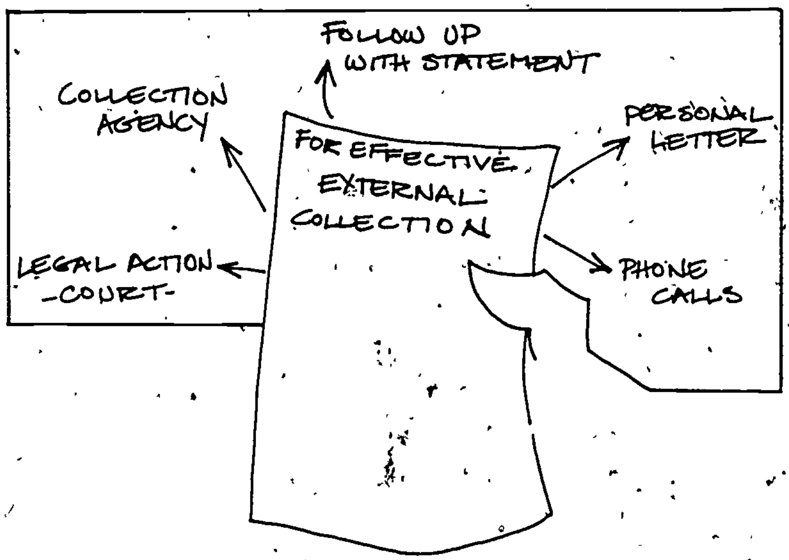
In some states, it is also illegal to inform a debtor's relatives, employer, or other close associates about a debt in order to obtain payment. Additionally, collection letters may not be sent in such a way that the envelopes indicate that a debt is owed. These laws are designed to prevent unfair collection practices and to protect debtors from embarassment and invasion of privacy.

The legal rights and recourse of debtors and creditors are extremely important. Managers of businesses offering credit to their customers need to be aware of these provisions. The manager is required to inform the customer of such rights and avenues of recourse. Legal advisors such as government agents, attorneys, and accountants should be contacted for additional clarifications and interpretations of credit laws.

WHAT VARIOUS COLLECTION PROCEDURES ARE USED?

An understanding of applicable credit laws is necessary when a business manager establishes and executes collection policies and procedures.

Whether or not your business chooses to use cash discounts for prepayment or delinquency charges for overdue payments, a systematic follow-up procedure should be employed with all past-due accounts. Usually, this will take the form of a series of reminders, letters, and telephone calls.



The following is an example of a reminder sent to customers who have not paid their bills within 30 days. These reminders may be a brief mimeographed form letter.

> **REMINDER OF PAST DUE BILLS**
>
> Our records show that your balance for the amount of ________ is now past due. Please give this your prompt attention. (Finance charges on overdue accounts are charged at the rate of 2 percent per month.)
>
> If payment has been made by the time this reaches you, please disregard this reminder and accept our thanks.
>
> LeRoy's Clothing

WHAT ARE SOME EXAMPLES OF A COLLECTION LETTER SERIES?

When an account is approximately 30 days past due, the first collection letter should be sent. Since the account cannot be considered seriously delinquent at this time, the tone of the letter should be moderate. Subsequent letters should establish a firmer tone, so that the customer is made aware of the seriousness of the situation.

The 30-day past-due letter might read as follows:

> Dear Mr. Adams:
>
> According to our records, your current balance is $473.25. Of this amount, $215.38 is more than 30 days past due. As you know, our terms require payment within 30 days after the invoice is sent.
>
> Since you have established an excellent credit rating with us, we are wondering if there is some problem. If there is an error in our records, or if you are unable to pay the amount due at the present time, please contact me so that we can correct the situation or make arrangements for payment.
>
> Thank you for your attention to this request.
>
> Sincerely,
>
> J. Madison

A second letter, sent 30 days later, might read as follows:

> Dear Mr. Adams:
>
> We have received no response to our last two statements, nor to our letter of September 15. Your entire account is now 45 days overdue. The total due is $473.25.
>
> If there is some reason why this payment cannot be made immediately, please contact us so that we can make mutually agreeable arrangements.
>
> Naturally, we do not want to endanger your credit rating or destroy the good relationships that we have maintained in the past. If you take care of this obligation immediately, we will not have to file an unfavorable report with the credit bureau or resort to the use of an outside agent.
>
> A self-addressed envelope is enclosed for your convenience. We are confident that you will attend to this matter promptly. Thank you for your cooperation.
>
> Sincerely,
>
> J. Madison

If this letter is unsuccessful in obtaining results, a more forceful letter should be sent 30 days later:

Dear Mr. Adams:

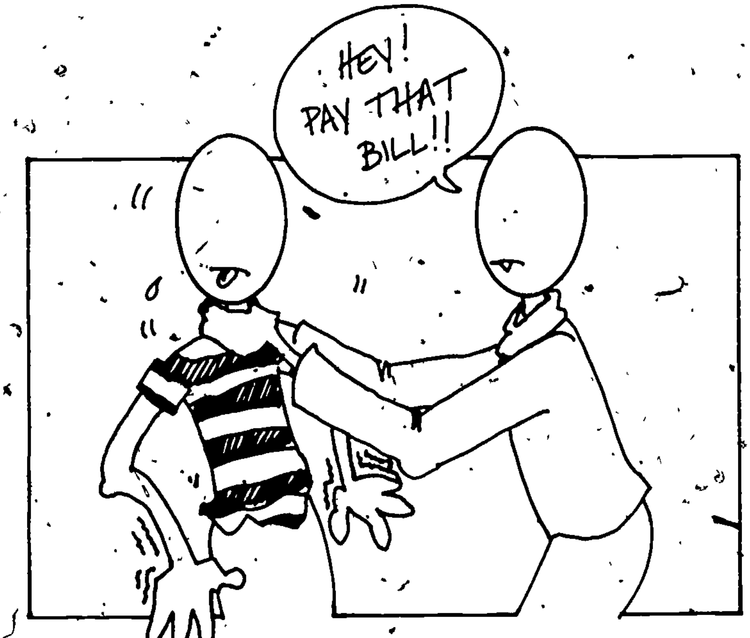
We have gotten no response to our last three statements, nor to the letters of September 15 and October 15. Your entire account is now seriously past due! It is obvious that our efforts to clear the account on a mutually agreeable basis have not been successful. Unless we receive payment from you within seven days, or negotiate a mutually agreeable arrangement for you to discharge this obligation, we will report the matter to the retail credit bureau.

Subsequently, the account will be turned over to a collection agency or to our attorneys for further action. Since this is a costly procedure, and will cause serious damage to your credit rating, I wish to suggest that you phone us immediately so that we can close the matter without resorting to these procedures.

Sincerely,

J. Madison

The tone of each letter should become progressively more forceful, with suggestions of more serious action introduced in each. The tone that you establish depends on the type of relationship that you maintain with your customers. However, the ground rules should be clear. Past-due accounts should not be ignored.



An even more persuasive approach is the use of the telephone. The ground rules are basically the same. You must become progressively

firmer with each call, and must indicate that stronger measures will be used if necessary to ensure prompt payment.

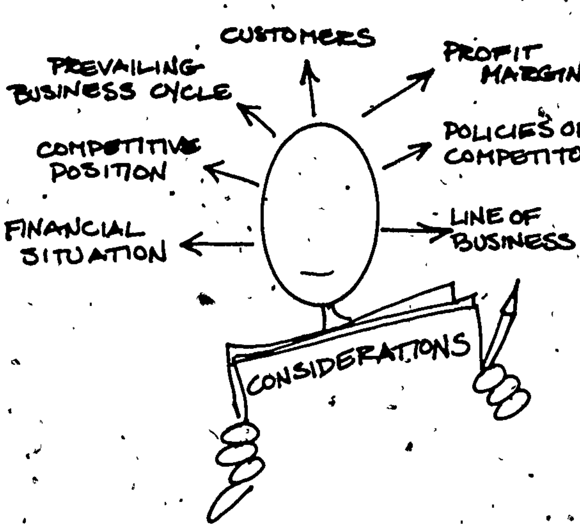
The telephone has the added advantage of flexibility, since you can be more direct and obtain knowledge of the customer's situation. A customer's immediate reactions can be obtained from a telephone conversation.

You acquire this knowledge through asking questions such as the following—

- "What seems to be the problem? We never had difficulty with your account in the past."
- "How much would be a reasonable amount for you to pay each month? Perhaps $50, $60?"
- "How soon can we expect payment of this amount?"

Try to avoid questions that can be answered "yes" or "no." If the creditor gives you an answer, such as, "I'll mail it today," reply with: "I appreciate that. Then I can expect it in two or three days. If I don't have it by then, I'll phone again."

Be sure that the creditor realizes that you do not intend to ignore the situation.



WHAT CONSIDERATIONS SHOULD BE INCLUDED IN CREDIT AND COLLECTION POLICIES?

The establishment and execution of credit and collection policies can minimize problems associated with accounts receivable. Whether a firm has an easy-going or strict credit and collection policy depends on these factors:

- The profit margin on the merchandise
- The line of business and its customers
- The policies of competitors

- The phase of the business cycle at the time
- The store's competitive position
- The financial and other circumstances peculiar to the business

WHAT ARE SOME EXAMPLES OF EASY-GOING AND STRICT COLLECTION POLICIES?

Businesses with similar merchandise, similar customers, and similar images usually have similar credit policies. When two firms have different merchandising policies, the differences are usually reflected in their credit policies. Credit policies, easy-going or strict, may be divided into four categories, which are described below.

Easy-going granting and easy-going collection. A business using this policy extends credit to consumers with excellent, good, and average credit ratings, as well as to those with just fair or poor credit standing. The aim is to achieve the highest credit sales volume possible. Little pressure is used in collecting.

Easy-going granting and strict collection. Under this policy, credit is granted to all classes of risks. Usually the granting of credit is liberal because the owner believes that the firm is a better collector than competitors. A great deal of pressure is used in collections.

Strict granting and easy-going collection. Businesses that use this policy do not grant credit to customers who are poor credit risks. But the firm isn't strict when it collects payments from customers. The owner justifies this approach by the careful selection of the credit customers, who, he or she believes, can generally be trusted to pay their bills.

Strict granting and strict collection. Sometimes firms find it necessary to become more strict in their credit granting and collection policies. When the sizes of the losses in their consumer credit divisions increases because of the cost of borrowing money and other operating expenses, the companies become more selective in adding new accounts and more forceful in collecting overdue payments.

A summary of a credit card and/or direct credit policy is as follows:

- Put in writing a policy that includes the objectives and the procedures for credit sales.
- Establish clear-cut procedures for authorizing credit purchases, stipulating the amount that can be allowed and the procedures for recording all the necessary information.
- Evaluate, at least once a year, the benefits and costs of credit, including a review of alternatives that could be used to reduce the total cost of granting credit.
- Provide a fairly clear-cut procedure for establishing credit limits for each individual.

- Change credit limits based on experience with customer payment practices.

- Develop a reporting system that allows easy review of outstanding balances at least once a month.

- Establish and adhere to a clear procedure for following up on late payments.

With the increased availability of computers, especially microcomputers, it is possible for a credit manager to have instant access to all credit files. Computer programs are available that automatically identify those customers who have exceeded their credit limits. Credit managers can easily review the current status of customer accounts before approving additional credit. It is also possible for sales personnel to determine the credit status of customers by using electronic cash register terminals programmed to provide such information.

In addition to determining the credit status of customers, a business may receive computer printouts (credit-card bulletins) of lost, stolen, or withdrawn credit cards. If the credit card number is not in the bulletin and the purchase amount does not exceed the credit limits, the sale may be charged to the card. Businesses who check customer credit frequently install a small direct-access computer in their firms. The use of credit cards and computers reduces the number of decisions to be made by sales personnel in making a charge sale. Since credit card companies assume much of the responsibility for collecting payment from the customer, their fee of 3-6 percent of the amount purchased may be well worthwhile. Owner/managers are increasingly adapting computerized credit systems for the above reasons.

All policies must be reevaluated periodically to determine their effectiveness. If your business already has policies for accounts receivable management, evaluate them according to the checklist your instructor will give you. If you do not presently have credit and collection policies, you can use the checklist as a guide in establishing thoses policies.

HOW CAN CREDIT PROMOTIONS BE PLANNED AND IMPLEMENTED?

Once credit and collection policies and procedure have been formulated, it is logical that effective credit promotions should be planned and implemented.

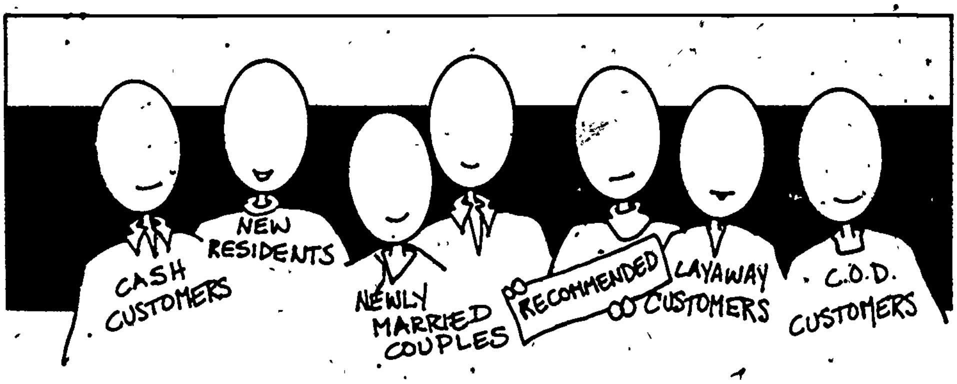
Is the promotion of credit worthwhile? In those businesses where credit can be extended, the answer definitely is "yes." There are good reasons why effort should be made to increase credit volume.

Charge accounts have made buying more convenient for customers. Surveys show that credit customers buy better merchandise and buy more goods than do cash customers. The convenience of paying once a month, of being able to buy on impulse or for necessity, rather than as funds dictate, and of being able to take advantage of attractive offers, more than exceeds any inconvenience.

A credit customer offers the store greater sales potential. A closer relationship is established between customer and store, cemented by the very nature of the credit privilege. Patronage takes on the form of habit, and the customer tends to regard the store somewhat as a shopping home. It is looked upon as "their" store. As a result, credit customers are apt to become boosters for the store. Being store-conscious, they give more careful and more frequent attention to the store's newspaper advertisements. They are also good recipients of direct-mail advertising.

Present and New Customers

To promote credit, three avenues should be considered: (1) obtaining new accounts, (2) getting inactive accounts to resume buying, and (3) increasing sales to all credit customers. Effort should be directed toward getting more business from existing customers and adding more good customers.



WHAT ARE SOME SOURCES OF NEW CREDIT ACCOUNTS?

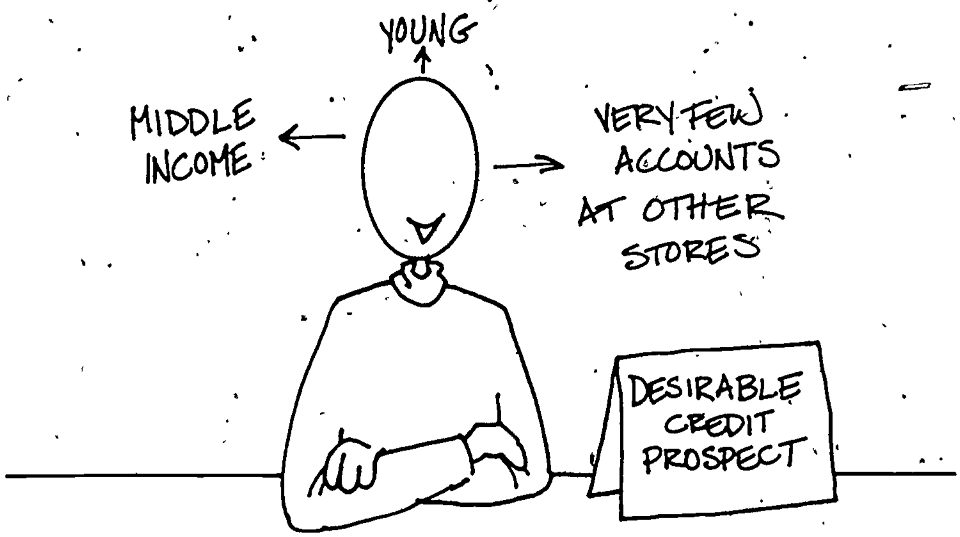
There are many sources from which credit account prospects may be obtained. Here are a few:

- The firm's cash customers
- New residents in a community
- Newly married couples
- Customers who use credit accounts
- People for whom the store cashes payroll checks
- COD customers
- Layaway customers
- Recommendations from good customers
- Customers to whom service is given, such as alterations, repairs, and so forth

- Sources such as reliable recommendations, teachers' lists, clubs, newspaper publicity about promotions, store personnel (relatives), and so forth.

HOW CAN NEW ACCOUNTS BE OBTAINED?

Obtaining new charge customers is desirable, but simply adding names to a current list is not enough. Not all accounts are the same as far as sales potential is concerned; some are more desirable than others. For example, an ideal customer would be that person who would buy primarily in one store and would have only that account. A person with accounts at many different stores enjoy a top credit rating, and their buying at any one store may be limited. The highly desirable type of credit prospect has been described as: young, from a middle income group, with few if any accounts at other stores. Whether the prospect is classed as ideal or average, however, effort should always be made to "sell" the store.



In attempting to get new customers, the usual careful selection procedures should be followed. Some stores obtain credit reports on prospects beforehand, while others extend the invitation first and then check the applicant. In either case, a customer investigation must be carried out before the account is opened.

HOW SHOULD A CREDIT PROMOTION LETTER BE WRITTEN?

Credit promotion letters are an important part of the campaign to increase credit sales, and there is much to be said for their use. A letter goes directly to the prospect. It can be made a personal message. It has the advantage of telling the business' story to a number of prospects at the same time. Letters should be individually typewritten on a good grade of paper, and should be personally signed for best results. First-class postage should be used in the effort to make this a sincere, quality solicitation. A sample letter that could serve as ideal material for promoting credit business is shown on page. A word processor with a merge capability makes individually typed, personalized letters to large numbers of customers possible with a minimum of typing time needed.

Sansone's

April 29, 19--

Mr. Charles Franklin
12 Given Road
Indianapolis, Indiana 46208

Dear Mr. Franklin:

We are always eager to add the names of those worthy of credit to our list of charge customers. Since you have been highly recommended, we invite you to open an account with us.

You will find that a charge account offers real advantages. It establishes a closer relationship between you and our store. Salespeople learn to know you and your preferences. Shopping is easier and quicker.

To make credit buying handy for our customers, we use the Credit Card system. Soon after you open an account, you will receive a credit card with your name and address on it. This card is inputed into our computerized cash register system. It identifies you immediately at the time of purchase and completes the sales transaction quickly and efficiently.

If you will complete the enclosed application form and mail it to us in the enclosed postage-paid return envelope, we'll arrange to open an account for you. We'll welcome you into the ranks of our charge customers, and we hope you'll always feel that Sansone's is *your* store.

Cordially yours,

Joseph R. Moore
Credit Manager

JRM:vlg

Enclosure

We're Your Store! 2739 South Richfield Blvd. Parkville, Your State 14571

WHAT ARE SOME REASONS FOR CONTACTING INACTIVE AND ACTIVE ACCOUNTS?

While the extension of credit to customers may be considered a favor, the customer regards it as a right. One of the reasons for a decrease in credit purchases by a firm's present customers is the improper handling of customers by the firm's salespeople. The proper handling of customers is just as important as the proper handling of merchandise. Unsatisfactory merchandise can be returned and any dissatisfaction remedied, but making up for unintelligent treatment of customers is far more difficult. Customers rarely tell the firm when they are irritated or displeased; they simply take their trade elsewhere. Increasing sales to all credit customers and getting inactive accounts to resume buying can be achieved partly through intelligent and considerate treatment of the credit customers by salespeople.

About once a year, it pays to send a personal letter to good credit customers, thanking them for their patronage and cooperation. Letters of this kind are appreciated by customers and they help to keep them as regular patrons.

WHY SHOULD CREDIT BE CONTINUALLY PROMOTED?

Department stores promote credit constantly. In fact, in the department store, credit is sold to customers much the same as is merchandise. Promotions of credit accounts must be a continuing program, because many customers are lost each year. Some discontinue patronage through what they consider faults of the store, but a greater portion of loss is the result of conditions over which the store has no control, such as deaths, changes of residence, and unemployment.

People like to be offered credit privileges rather than to be obliged to ask for them. A year-in, year-out program of account promotion should be maintained. It should include the securing of new accounts, the revival of inactive accounts, and the promotion of greater activity among accounts already on the books.

The cost to a store of opening a charge account has been estimated to be in excess of $25, including the credit interviewer's time, setting up the forms in the account file, the cost of credit investigation, and issuing the charge card. Losses due to bad risks in department stores are usually only a fraction of 1 percent of sales. Some credit managers believe that if the loss is too low, the firm's credit policy is too strict, and they are not taking full advantage of their sales opportunities. The average charge account yields around $400 a year for the department store. Since charge customers spend more than cash customers, it is clear why so many stores steadily campaign for credit business.

WHAT CREDIT INFORMATION MANAGEMENT RESOURCES AND SYSTEMS ARE AVAILABLE?

The manager of a small firm should get to know and understand various sources of credit information. Certain types of information are sold by the mercantile credit agencies; other types are available from them as a service or on an exchange-of-information basis.

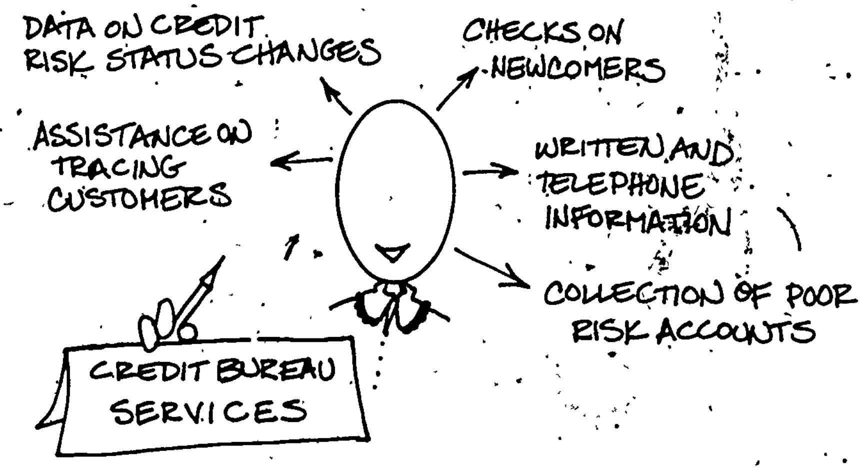
Arrangements can be made with suppliers' credit departments to exchange information. This type of interchange can be very valuable when up-to-date sales and payment records of current or prospective

customers are being sought. The owner/manager should recognize that a firm's performance with major suppliers is also a matter of its record in the trade.

Banks are usually good sources of information about their depositors. Often, they can make a good estimate of the amount of credit a depositor can handle. They can also help get credit information on out-of-town customers—particularly if it is important to process a new order speedily or to check out a possible bankruptcy situation. The owner/manager should be careful not to take advantage of a bank by making too many requests for credit information.

Firms needing daily credit information—for example, a retailer checking on consumer credit applications—should consider buying the services of their local credit bureau. Credit bureaus are particularly effective in rating persons living in the local trading area. Their effectiveness is increased through their cooperation with the International Consumer Credit Association or the Associated Credit Bureaus of America. These associations develop credit information on persons who have moved from one town to another.

Services offered by credit bureaus include: checks on newcomers in the trading area; written and telephone credit information on individuals; data on changes in customers' credit risk status; assistance on tracing customers who leave town without providing a forwarding address; and collection of poor risks accounts.



A typical consumer credit report would include such information as: credit accounts maintained; history of purchases; balances due; promptness of payment; period of time that the account is maintained; consumer's net worth (home, car, and so forth); employment verification (data on income, position, and duration of job); and character information (police record, if any). A business need not be a member of the local bureau to obtain credit information; usually, however, nonmembers pay higher charges for services.

Manufacturers and wholesalers often use the services of mercantile credit agencies. Privately owned and operated, these agencies

continually collect, analyze, and evaluate credit information on business firms. Their credit ratings are based on the observed experience of the reporting firms. Services are provided by fee, based on the range of information required.

Among the general mercantile agencies, Dun & Bradstreet, covering many industries through the country, is the best known. D & B offers its reference book, credit reports, and other special information to firms that buy its service. The reference book includes credit ratings, evaluations of financial strength, and other vital credit information. Lyon Furniture Mercantile Agency provides data on furniture retailers for furniture manufacturers and wholesalers. The Jewelers Board of Trade offers similar services to the jewelry industry. The National Credit Office, originally organized to handle credit inquiries in the prinicipal textile trades, now also reports on banking, metals, electronics, leather, furniture, paint, rubber, and chemicals.

If the owner/manager uses the services of a "factor," a credit and collection system does not have to be maintained. The factor establishes a working procedure for clearing credit for new customers, for setting up credit limits for old customers, and for collecting accounts receivable. Accounts receivable are then bought outright from the selling firm.

The owner/manager should also keep in touch with competitors and other firms whose activities are related to the firm's customers. The exchange of credit information between business managers can be quite valuable—particularly if a customer's financial position weakens. Timing is vital if the owner/manager hopes to protect the firm's position as a creditor.

Credit and collection skills can be improved by attending financial workshops and by reading current literature on the subject. Workshops are given by local credit organizations, universities, trade associations, and other educational groups. Any number of publications are available through organizations or libraries, publishers, the Small Business Administration, other state and national governmental organizations, and so forth.

ACTIVITIES

Do you know enough about managing credit and collections to put some of your skills into practice? The following activities will help you experience some of the real-life situations of owner/managers.

INDIVIDUAL ACTIVITY

The purpose of this activity is to assist you in reviewing specific legal terms and concepts applicable to credit and collections. Such terms are contained in this unit.

On a separate piece of paper write the appropriate terms to complete the following definitions:

1. This type of credit allows for adding to the amount owed for as long as monthly payments are made.

2. This type of credit involves someone making a purchase and agreeing to pay for it at a later date.

3. The purpose of Regulation Z (of the **Truth in Lending Act**) is to let borrowers and consumers know the exact cost of obtaining credit. True or False?

4. Under Regulation Z, any business issuing credit must disclose two things before completing the transaction. These include:

   A. The ________ charge

   B. The annual ________ rate of interest

5. Under Regulation B of the Equal Credit Opportunity Act, creditors may not discount whose income because of sex or marital status?

6. The Fair Credit Reporting Act provides that the credit reporting agency must tell the individual the nature of ________ that they have on file for him or her.

7. What kind of loan is the one in which creditors obtain rights to something of value from which they can recover the amount of the loan if the debtor fails to repay the amount due?

8. In what kind of sale does the title to the merchandise remain with the seller until the purchase price has been paid?

9. Under conditions of a secured loan, if a debtor does not pay, the secured party has the right to ________ the goods.

10. The Fair Debt Collection Act makes it a federal offense to threaten consumers with ________, use ________ language, or contact consumers by telephone at inconvenient ________ or ________ in an effort to collect a debt.

GROUP ACTIVITY

In groups of three, discuss the responses that you would provide to the following telephone collection situations. In each case, you have received no responses from reminders and letters. Before turning these problems over to a collection agency, you decide to telephone these customers. During the course of your conversations, the following customer reactions occur. As a group, decide on the most effective responses.

1. The customer becomes defensive and angrily complains about the store's goods and services. He offers these complaints as the major reason for lack of payments.

2. The customer acknowledges the bill, but then tells a sad story about personal and financial problems.

3. The customer denies that any notices or statements have been received.

4. The customer says that the spouse charged these bills and that he or she will not be responsible for them.

CASE STUDY

Suppose that a number of new accounts with your business are delinquent. You analyze these accounts and discover that the majority of them are accounts of newly married couples. Since your store is located in suburban shopping center, more and more of your customers come from a younger age group. You are concerned that these customers will develop bad payment habits that will result in difficult collection problems.

Mr. and Mrs. Gordon Blake exemplify this type of delinquent customer. They have been married for three months, have a relatively low income, are young, are carrying heavy mortgage and installment payments, and are two months behind in their installment payments to your store. Write them a *personal letter* reminding them of their responsibilities and obligations. In this case you will want to retain them as customers of your business.

Check your letter to ensure that—

- Your introduction explains the purpose of the letter.
- Your introduction is friendly, courteous, and appeals to your desired audience.
- You explain the credit policies of the store in an understandable manner.
- You tactfully explain the problems resulting from late payments and poor credit ratings.
- You conclude the letter in a positive manner.

ASSESSMENT

Directions: Review the following statements to check your own knowledge of these topics. When you feel prepared, ask your instructor to check your competency on them.

1. Distinguish two major differences between open-end and closed-end credit plans.
2. Identify four points of information that must be disclosed in open-end credit advertisements.
3. Identify four points of information that must be disclosed in closed-end advertisements.
4. Explain the major purpose of Regulation Z of the Truth-in-Lending Act.
5. Identify the two points that a creditor must disclose to the debtor before completing the credit transaction.
6. Identify an injustice that was intended to be remedied by the Equal Credit Opportunity Act.
7. Identify what the Fair Credit Reporting Act requires the credit reporting agency to provide to customers.
8. List three legal security devices that may be used by a seller.
9. Identify four illegal collection practices.
10. Discuss three characteristics of an effective series of collection letters.
11. Identify three examples of effective telephone collection techniques.
12. Identify four factors upon which to base credit and collection policies.
13. Identify six different possible credit promotion strategies.
14. Identify four credit information resources and systems.

SOURCES USED TO DEVELOP THIS UNIT

Dible, Donald M. *Business Start Up Basics.* Fairfield, California: The Entrepreneur Press, 1978.

Rosenberg, R. Robert; Whitcraft, John E.; and Brown, Gordan W. *Understanding Business and Consumer Law.* 6th ed. New York: Gregg Division, McGraw-Hill Book Company, 1979.

U.S. Small Business Administration. *Business Basics, Consumer Credit. A Self-Instructional Booklet 1013.* Washington, D.C.: U.S. Government Printing Office, 1980.

U.S. Small Business Administration. *Business Basics, Credit and Collections: Policy and Procedure, A Self-Instructional Booklet 1014.* Washington, D.C.: Government Printing Office, 1980.

For further information, consult the lists of additional sources in the *Resource Guide.*

Level 3

PACE

Units on the above entrepreneurship topics are available at the following three levels:

- Level 1 helps you understand the creation and operation of a business
- Level 2 prepares you to plan for a business in your future
- Level 3 guides you in starting and managing your own business

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