

Minimizing Bad Debts

Ask for proper information up front, and collect aggressively.

Is there anything worse than doing good work and not getting paid? Everyone in business has to deal with the problem of bad debt, and it is possible to minimize this problem with proper planning. However, every article about minimizing bad debt begins with the same advice, and this article is no exception: Your goal should be to minimize but not eliminate bad debt. You must strike a balance between maximizing sales and minimizing bad debt. Credit policies that are too strict will inevitably hurt sales.

The Credit Application

Before extending credit to a customer, it is appropriate to learn something about the customer's financial circumstances. Your credit application should accomplish three objectives:

- Provide sufficient information to allow you to evaluate your customer's ability to pay.
- Identify the location of your customer's significant assets.
- Impose contractual obligations on your customer if you have to take legal action to get paid.

Information regarding a customer's employment history and assets will help you evaluate whether your customer has the financial stability and resources to pay you for your services. Has the customer been employed at his current employment for a long time? If not, does the employment history suggest someone who cannot keep a job?

Ask how long the customer has been in the current home. Also ask about the fair market value of the home and the outstanding mortgage liability. Is the customer's equity reasonable, given the amount of time that he or she has owned the home? Lower-than-expected equity may be a sign of too much borrowing by the customer.

The credit application should identify your customer's bank or credit union. It is also wise to ask the customer for his or her bank account numbers. If you have to take legal action against the customer, this information will be useful in enforcing your judgment.

A good credit application will outline the terms upon which credit will be granted. In effect, the application can become the contract once credit is extended. The application should include a provision requiring your customer to pay your attorney fees and court costs if you have to take legal action to collect. You might also include provisions for late payment penalties and interest on any unpaid debt.

The Collection Process

Establish an aggressive policy for monitoring accounts receivable. If a payment is not received promptly, have an employee call the customer to find out if there is a problem. Ask the customer for a firm date by which payment will be received. Follow-up to assure that payment is received by the promised date. If it is not, have a procedure for written communication with the customer.

If two or three repeated efforts to collect are unsuccessful, consider more aggressive steps. Some service providers prefer to use a collection agency to pursue bad debts, particularly if their office staff lacks time or training in collection practices. Alternatively, depending upon the size of the debt, you might wish to consider taking legal action immediately. Many debts can be adjudicated quickly and inexpensively in small claims court. Throughout the collection process, keep good records. Telephone logs of calls and copies of correspondence will be necessary to establish your claim if you have to go to court.

Michael P. Coyne

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