

# C R E D I T

## Where It's Due (You)

*To whom should you extend credit? How can you find a debtor who moves? What can you do to collect payment when the customer's check bounces? The author sets forth guidelines to help you control your accounts receivable, receive prompter payments, adhere to regulations pertaining to credit, and earn money on the credit you extend*

by **Walter H. Page**, *American Credit Control*

DELINQUENT ACCOUNTS worth approximately \$3.5 billion were turned over to collection agencies in 1977. Perhaps another billion dollars' worth fell into the hands of such independent collection media as attorneys and local justices. And the cost of unpaid bills is estimated at roughly \$50 annually for each person in this country. In other words, your cost of living this year will include \$50 attributable to others' unpaid debts.

But you bear more than the indirect cost of delinquent accounts as a consumer. As a member of the business community, you also shoulder the direct cost of bills not paid by your own customers. Many of your losses may result from overly lenient credit policies, inconsistent policies, or — worse — no policies at all.

Those who establish business enterprises are generally experienced in a particular field or in selling a certain product. They mistakenly assume that their expertise in this endeavor will ensure the success of the business, despite their unfamiliarity with such fields as finance and credit. And many businesses

fail, or take in fewer profits than they should, precisely because the principals lack knowledge in these fields.

This article will introduce you to proven techniques of credit management. Whatever your type of business, whether you handle collection activities yourself or hire a professional collector, the suggestions offered here will help you to establish better controls, elicit prompter payments, and improve your profit margin. They will also show you how to stay within the bounds of legal restrictions pertaining to credit, although these general guidelines should be supplemented with counsel from your

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**No one enters a place of business and says, "Give me that, but I am not going to pay for it." Instead, the customer may say, "Bill me the first of the month," or, "I'll send you a check." Unfortunately, these promises are often broken.**

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attorney. Finally, they will impress on you the importance of approaching credit matters with both common sense and imagination, because no two accounts or situations are alike.

### **Know the Law**

Recent rulings by Congress are explicit in defining acceptable and unacceptable debt-collection practices. The following overview of the pertinent sections of the Consumer Credit Protection Act\* will give you some familiarity with the basic concepts of collection law, but you should consult your attorney for answers to specific questions and for information on regulations pertaining to collection in your state. Note that these laws apply not only to collection agencies you engage, but also to any representative of your firm who participates in collection efforts.

#### **Section 804**

- The consumer is guaranteed privacy in the collection effort. If you communicate by telephone or the mails with a third party — while attempting to locate the debtor, for example — you are prohibited from mentioning or indicating in any manner that the consumer owes a debt.

- In mailed communications to debtors, you are not allowed to use any language or symbols on the outside of the envelope that could indicate the envelope's contents relate to a debt. A firm named Ace Collection Agency, for example, could not use its name on an envelope.

- The use of postcards for collection notices is specifically prohibited.

- If asked, a collector talking with a third party for the purpose of locating a debtor must identify his firm. Under such circumstances, it is acceptable to reply, "I am Mr. Johnson of Acme Credit Service." However, you cannot say that the consumer owes a debt; you can only say, "This is a business matter," or, "This is a personal matter."

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\*Public Law 95-109, an act of Congress effective March 20, 1978.

†What constitutes a reasonable time period has not yet been defined by the courts. In any situation involving an attorney, try to establish a set time limit within which the attorney must report his decisions to you.

- If the debtor has turned the matter over to an attorney, and you receive notice that the attorney has been engaged, you may not communicate with anyone other than the attorney, unless the attorney fails to respond to your communications within a reasonable length of time.† If you receive written or oral notice that an attorney is representing the debtor, you should ask whether the attorney is representing the consumer in the matter of your account. The attorney may actually be representing the consumer on an altogether different matter, rather than protesting the account.

#### **Section 805**

- The collector is not allowed to make phone calls to the debtor at unusual hours, on holidays, or on Sundays. The most recent ruling on this issue specifies that calls may be made from 8 AM through 9 PM (in the *debtor's* time zone) during business days. If the consumer has indicated he works odd hours and cannot be reached by phone during the permissible calling hours, you may be allowed to place calls during the hours the debtor is available.

- You may not call the debtor at his place of employment unless he agreed at an earlier time to accept phone calls at work (do not even consider this option unless you have the debtor's permission in writing). You may write to a consumer at his place of employment as long as you adhere to the regulations pertaining to written communications.

- The Truth-in-Lending Law permits the consumer to tell you he will not pay the debt and that he does not want any further communications from you. In such cases, the debtor should send you written notice of his intent not to pay and specify his reasons. Upon receipt of the notice, you must stop collection efforts but can notify the debtor that legal action will be taken. You may say this only if you intend to take legal action; you may not use it as a threat or an attempt to coerce the debtor into paying.

- You may not abuse or harass the debtor. Abusive language, repeated phone calls, and threats of physical harm are prohibited.

- You cannot threaten to recover merchandise or lien property unless this eventuality is covered by the original terms of your agreement with the debtor and unless you intend to act on your warning. Property can be liened in most states as part of a court-authorized judgment.

#### **Section 806**

- You may not make an inordinate number of calls to the debtor, because repeated phone calls may be construed as harassment.

- When you call or visit the debtor, you may not represent yourself as someone other than yourself. It is illegal to indicate in any way that you are a gov-

ernment representative, even by implication (e.g., by wearing a uniform or badge that might be interpreted to indicate affiliation with a government agency).

### Section 807

- You may not add charges to the debtor's account or represent that additional charges will be levied if the account is turned over to a collection agency or to an attorney — unless the amount of collection charges is specified in the original contract.

- You may not say you are an attorney or that you are employed by an attorney if you are not.

- You may not use any forms or other written materials containing such words as "Legal Department" or other indication or implication that the materials were issued by an attorney, if they were not.

- No form or notice you send may simulate a summons or other legal document.

- If you notify a debtor that he is about to be sued for nonpayment, you must sue him. *You cannot send a notice of intent to sue unless you will take the action.* Such a notice should specify the date that action will be taken.

- You may not furnish false information to a credit-reporting bureau for the purpose of discrediting the debtor.

- If an account routinely monitored by a credit bureau is disputed (see "Disputed Accounts," below), you must so advise the credit bureau. Failure to inform the bureau may lead to a violation of the consumer's rights — and perhaps allow the consumer to sue you for recovery of damages.

- You may not charge interest unless the amount to be charged is expressly mentioned in the contract and permitted by law (see "Interest," below).

Any person performing collection activities must adhere to the foregoing regulations. Failure to comply in any respect can result in penalties, fines, and lawsuits.

## Extending Credit

Anyone who extends credit is, inevitably, vulnerable to some losses. In addition to the straight dollar amount of bad debts, slow accounts are expensive in a number of ways. They increase your bookkeeping and interest costs. By tying up the operation's capital, they can keep you from taking advantage of profit-making opportunities. They may force you to borrow (and make it difficult for you to do so). By cutting into your profits, the expense of slow accounts may ultimately cost you customers — first, because it prevents you from offering more competitive prices and products, and second, because the customers who owe you money are likely to take their business elsewhere. Many retailers compete

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**If you ask a typical member of the business community how much money his past-due accounts represent, he'll tell you to ask his clerical staff or say, "I'll have to look at the books." He assumes he can recover all the money due him by exerting a little effort — but a good fifth of his money will never be collected.**

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among themselves by offering easy credit terms to customers. They hope to improve their business this way, but in fact only the consumer stands to benefit.

You can limit your credit-related losses by taking a systematic, consistent approach to the extension of credit. Credit is a privilege, not a right, and granting it should be based upon such factors as the consumer's ability to repay, his current solvency, his past performance in repaying credit accounts, his present employment, and the amount of the transaction.

The most common type of credit extension is the acceptance of credit cards issued by banks and other entities. If you accept consumers' credit cards, the credit-card companies charge you a specified portion (usually two to five percent) of the amount of the transaction, and the headaches of collection are assumed by the card-issuing companies (except when you accept an invalid card).

You can also extend credit yourself. By applying the principles set forth in the following section, those who wish to extend credit to consumers will be able to (1) increase their business and (2) make money on the credit they extend.

### Interest:

#### The Extra Earning Power of Credit Sales

Credit sales can yield additional profits in two ways. First, you can expect your sales volume to grow because customers will take advantage of the availability of credit. Second, you are entitled to charge a fee for extending credit. The current ceiling on service charges is 18 percent of the transaction amount annually, or 1½ percent per month.\*

You can add service charges only if you consistently advise customers of the conditions under

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\*In calculating the service charge, remember that you add 1½ percent of the original purchase price only; although the outstanding balance for a given purchase will grow each month as service charges are added, the monthly service charge and the principal remain constant. For example: For an account of \$100, a service charge of \$1.50 is added for the first month past due (total due: \$101.50). The second month, the service charge is 1½ percent not of the total outstanding — \$101.50 — but of the original purchase price (\$100). Hence, \$1.50 is added again in the second month, bringing the account to a total of \$103; the third month, the outstanding balance is \$104.50.

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## **E**stablish a policy for extending credit, and adhere to it at all times.

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which such charges are levied and the amount to be charged. Printing a statement like the following on your invoices provides sufficient notice:

**Payment terms:** 30 days. Service charges are assessed in the amount of 1½ percent per month (18 percent annually) on all past-due accounts.

If you intend to assume the risks attendant upon extending credit, you should also take advantage of the additional profits available to you through service charges.

### **The Credit Application**

The first step in credit management is the prudent evaluation of persons asking for credit. You need complete information about each credit applicant, both to judge the applicant's ability to pay you and to help you locate the debtor if problems arise later.

Establish a set policy for extending credit, and adhere to it at all times. Have credit-application forms or cards printed, and ask every credit applicant to complete one. Make no exceptions. The form should ask for the applicant's name, address, phone number, place of employment, bank, credit references, and signature.

- Ask for the applicant's complete name; don't settle for initials. If you must attempt to locate the debtor later, you'll need to use all the information at your disposal.
- Require a full *residence* address. The applicant does not live in a post-office box, or at a rural-delivery number, but in a home of some kind.
- It is especially important to get the applicant's phone number. If a debtor ignores your statements, you will need a way to contact him. A person without a phone may be a transient, or unable to afford a phone. Even if the applicant's number is unlisted, insist that he give it to you (he may have requested an unlisted number to avoid other creditors). Do not accept the phone number of an applicant's friend or relative: such third parties may well refuse to convey messages. As noted earlier, it is dangerous to use an employer's phone number unless the employer and the employee authorize it.
- Require the applicant to identify his place of employment, and verify the information through a phone call to the employer. If the applicant is self-employed, determine the company's name, the applicant's title, and the nature of the business.
- A bank reference is always desirable, and when large sums are involved it is mandatory.
- Ask for three credit references, advise the applicant they will be checked, and follow through.

Ask the references about the applicant's performance in repaying his accounts.

In collecting this information from an applicant, remember that the sole criterion for extending credit is the applicant's ability to repay the account.

### **Special Cases:**

#### **Women, Senior Citizens, Teenagers**

It is illegal to deny credit on the basis of an applicant's gender. Because a woman's credit history may require special treatment — if all records of payment are in her husband's name, for example, or if she has worked exclusively as a homemaker — ask the loan officer at your local bank to explain the bank's procedures in evaluating woman credit applicants.

Another applicant who may require special consideration is the senior citizen. If a retired debtor defaults on an account, collection will be difficult; although you can take legal action for recovery, you cannot attach a Social Security, pension, compensation, or disability check. A rule applicable to any extension of credit is especially important here: start with small transactions, monitor the debtor's repayment, and govern further extensions of credit accordingly.

Many creditors are reluctant to extend credit to teenagers, but as a look at the record of nonpayment among adult customers will reveal, young people have no monopoly on delinquent accounts. If yours is a business serving the needs of younger customers — who, incidentally, have enormous spending power — don't force them to take their business somewhere else; just take reasonable precautions.

In extending credit to a person younger than 18, you must have a parent or legal guardian sign a written agreement stating that in the event of nonpayment the parent or guardian will be liable for payment (and check the parent's credit references). Set a limit on the amount of credit you extend. A young person will not have an established credit history, but if he is employed and has a good work record, consider granting credit. Begin with small transactions, spell out the rules of repayment fully, and let the individual know that his performance will dictate later, larger extensions of credit. Finally, consult your attorney for information on state regulations pertaining to the extension of credit to young people. Granting credit to a responsible young person can be a sound investment in your future business.

### **The Order Form**

By law, all credit transactions must be authorized via a signed order form. As is true of the information requested on the credit application, the information provided on the order form must be complete, including: the purchaser's full name, complete (street) address, and phone number; a list of all

items purchased (including serial numbers, if applicable) and the price of each; the total amount of the purchase and any sales tax; and the purchaser's complete signature.

If the purchase is made in a company's name, rather than to be charged to an individual, you should also obtain the following information:

- The name of the individual responsible for payment;
- The names, titles, home phone numbers, and home addresses of the company's officers or principals;
- The signature of the head of the company, authorizing purchases;
- The name of the company's bank, if a new firm; and
- Recent credit references (make a phone call to verify them).

When purchases are made in a corporate name, none of the corporation's officers is legally responsible for the payment of monies due; when purchases are made on behalf of a partnership or company, the owners are liable for business debts incurred, either individually or collectively.

Requesting complete information from credit applicants is prudent not only from the standpoint of facilitating collection activities at a later date: it also forewarns consumers that you take credit transactions (and their repayment) seriously. If a purchaser objects to your request for this information, simply say that your bank or supplier requires that you obtain the information from all new clients. Anyone unwilling to provide the information is suspect and should be denied credit.

Although the Truth-in-Lending Law is specific in stipulating how credit transactions should be handled, it is your privilege to extend credit only when in your considered opinion the resulting transaction would be good. Set a credit policy, establish criteria, and apply them consistently — without exception.

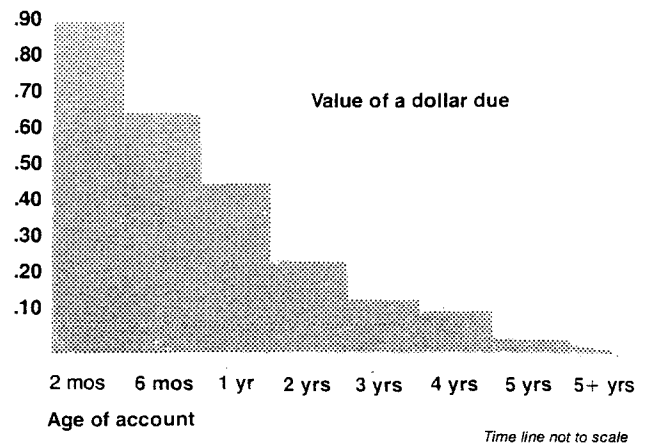
### **Accounts Receivable: Getting Your Money**

If you ask a typical businessman how much money his past-due accounts represent, he'll tell you to ask his clerical staff or say, "I'll have to look at the books." He should know.

It's easy to neglect accounts receivable — there are always plenty of other matters requiring immediate attention. But if you allow too much time to elapse before examining your books, or wait until you need money for some purpose of your own, you are making a critical mistake. Under these circumstances you may get angry at the individuals whose accounts are past due, or anxious because you are unable to pay your own bills. If you panic, emotional stress may

## **Past-due accounts: What they're worth**

Every day a past-due account remains on your books, it decreases in value — and the likelihood of its repayment drops sharply.



lead you to do things you shouldn't in the attempt to collect and your problems will only multiply.

In my experience, a businessman with, say, \$20,000 in accounts receivable ranging from six months to two or more years past due is often not especially concerned about the magnitude of his receivables because he labors under the misconception that he can recover all of the money due at any time just by exerting a little effort. This is a fallacy: in fact, a good fifth of his money is probably uncollectable. Develop the habit of checking your accounts, and your accounts receivable will rarely get out of control.

Every day a past-due account remains on your books, the value of its recovery and the likelihood of its recovery grow slimmer (see the chart above). It is therefore imperative that collection efforts start at an early stage in the delinquency. Create a filing system for receivables — color-coded or organized in some other way that will allow you to determine at a glance, as part of your work day, the accounts that may prove to be collection problems. Monitoring your accounts may yield valuable insights for your future credit policies, indicating areas in which you should modify the way you handle the extension of credit. As a general rule, at the end of three months of billings you should be prepared to commence collection efforts.

### **... by Mail**

You should send statements to consumers in accordance with an established billing schedule — at least once every 30 days, so that you can add the service charges as they accrue. A notice specifying the amount of the charge must be clearly printed on all statement forms; you are not permitted to rubber stamp, type, or write the charges on individual

**When billing debtors, you cannot indicate in any way on the envelope — say, by writing “Past Due” — that the contents relate to a debt.**

statements (this regulation is intended to prevent inconsistent application of the charge). The notice most often reads as follows:

NET Cash:

A 1½% per month service charge, or 18% annual fee, will be charged on all accounts 30 days past due.

Whatever the words you use, however, they must appear on *all* statements.

On your second statement, write or stamp the word “Please” — nothing more. If this tactful approach produces no results in 15 days, you have a collection problem, and your next statement should be more forceful. A series of suggested collection letters is shown on the facing page. Collection letters should be individually typed or, if this is not practical, they should at least be typed and duplicated in such a manner that they have the appearance of individually typed letters. As a rule, do not use stickers; in my experience they do not produce meaningful results and may actually postpone consumer action.

All collection correspondence should be typed on your letterhead. It is not legal to make up a different company name for the purpose of implying that a third party is now involved. State a time limit (10 or 15 days) for the debtor’s response on all collection letters — and then act on it. Unless you consistently follow up on the due dates you set, the debtor will not take your statements seriously and your collection efforts will be wasted.

Remember that if you send the debtor notice that you intend to sue, you must do so. If you receive no response to the last collection notice in the series within 30 days, you are required to turn the matter over to a collection agency or an attorney. Forward all pertinent information about the debtor and the debt (including a complete, itemized statement showing all the account’s debits and credits).

If the amount of the debt is small, you may be able to take the matter to Small Claims Court, where you need not use the services of an attorney. In some states only matters involving \$500 or less can be heard in Small Claims Court, while in other jurisdictions the ceiling is \$1,000. When possible, it is to your advantage to use the Small Claims Court. Be prepared with two copies of a complete, typed, itemized statement, showing all debits, credits, and service charges. If the debt exceeds \$1,000, obtain professional help.

**A Word About Envelopes**

You can enlist the aid of the U. S. Post Office in locating debtors by including the phrase “Address Correction Requested” on the envelope of every statement you send out. If a debtor moves and files his forwarding address, the Post Office forwards your mailing piece to the debtor and sends you the debtor’s new address on its Form 3547 (shown below). You are charged 25¢ for every address correction sent to you, and must pay a small fee for the correction service, but the investment is well worth it: obviously, you cannot collect from someone you can’t locate.

Because the Post Office keeps address changes on file for a limited time, transfer new addresses to your ledger cards immediately. If you receive notice of an address correction, you can be reasonably sure that the debtor received the statement; you therefore need not send another statement for that month and should wait for the next billing cycle.

What if the envelope is returned to you and marked “Unknown” or “Moved — Left No Address”? If you followed the procedures outlined earlier in this article, you know the debtor’s place of employment. You may call the place of employment and ask whether the consumer has informed that office of his new address; if so, forward the statement to the new address. If you do not receive Form 3547 from the Post Office, you can assume the statement was delivered. Your other option is to send a statement to the employer’s address in a plain white envelope. You *must* mark the envelope “Personal” in bright red. If you fail to do so, and the envelope is opened by a third party, you may be open to a lawsuit for invasion of privacy or, in the case of a disputed account, for dissemination of false information. You may not indicate in any manner on the outside of the envelope that you are billing for a past-due account. Any indication that the envelope contains a billing — including a phrase like “Second Notice” or

**U.S. Post Office Form 3547**  
*A useful tool in “skip tracing”*

Enter Mailer's Account No. Here: <i>(All numbers, dates and letters)</i>	THIS CARD IS FURNISHED:
Check if: <input type="checkbox"/> NO Acct. No. ON MAIL <input type="checkbox"/> Account No. ILLEGIBLE	<input type="checkbox"/> For address correction, as requested. <i>(Your mailing piece was forwarded)</i> <input type="checkbox"/> In lieu of Form 3579, see last space below.
Name of Addressee	_____
Old Address	_____
Post Office, State and ZIP Code	_____
New Address	_____
Post Office, State and ZIP Code	_____
The address portion of your 2d, 3d, 4th or controlled circulation mailing piece was not readily detachable. Reason for non-delivery was:	
<input type="checkbox"/> MOVED, NOT FORWARDABLE	<input type="checkbox"/> NO SUCH STREET
<input type="checkbox"/> NO SUCH NUMBER	<input type="checkbox"/> UNCLAIMED
<input type="checkbox"/> UNKNOWN	
PS Form 3547 Mar. 1977	U.S. Government Printing Office: 1978-733-322

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# Sample collection letters

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## First effort

Amount Due      Due Date (10–15 days)  
We find your account to be past due. Please remit promptly so that we are not required to take further steps.

Amount Due      Due Date (10–15 days)  
Your merchandise (goods, services) was (were) given to you in good faith. To date, no payment has been received. We will expect your remittance by return mail.

You should begin this series of collection notices when the debtor has failed to respond to three billings. All of these letters should be typed on your letterhead. You may find that typing the letters in upper-case letters is effective in getting the debtor's attention.

## Second effort

Amount Due      Due Date (10 days)  
Since we have not received payment on your account, we wonder whether there is some problem of which we are not aware. Please communicate with us and advise. Your failure to respond will lead us to believe that payment is being avoided.

## Third effort

Amount Due      Due Date  
A judgment can be taken against you for nonpayment of your past-due account. All court costs and interest will be added to the account. To avoid a judgment, and to prevent this matter from becoming a matter of public record, pay your account now.

*Note that, in the third letter (at left), you are only notifying the debtor that an action can take place — you are not saying that it will.*

## If you intend to take legal action

Amount Due      Date  
A legal action will be taken against you for nonpayment of your past-due account. All court fees and interest charges will be added to the account. This action will be taken 10 days from the date of this communication if we receive no response from you.

*This letter can be used only when you intend to take the legal action.*

Amount Due      Date  
**FINAL NOTICE**  
Unless payment is received within 10 days on your past-due account, it will be referred for collection.

*If you receive no response to this communication within 10 days, you must turn the account over to a collection agency or an attorney.*

Amount Due      Date  
**YOU WILL BE SUED**  
If you intend to avoid this action, it is imperative that you remit immediately and notify us that payment is on the way so that this action can be stopped.

*By law, if you receive no response to this letter within 30 days, you must turn the account over to a collection agency or an attorney.*

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“Past Due” — is prohibited. As noted earlier, using a postcard to bill a debtor is considered an invasion of his privacy.

You can help ensure that the debtor will open the envelope by using stamps, rather than a recognizable postage-meter imprint, and by listing your postal-box number as the return address. (If you rent a postal box, register its number as one of your addresses on the forms you file for return of Form 3547 to ensure you are informed of debtors' new addresses, regardless of the address you use on your envelope.)

### ... by Telephone

The telephone is an especially effective tool in collecting accounts when used properly. Remember when communicating with debtors to speak in a modulated voice and to avoid annoying mannerisms like throat-clearing. If the call is unpleasant, the

debtor will cut it short simply to end the irritation of listening. Prepare what you have to say — and say it pleasantly but firmly, using short and easily understood phrases. Although it may be difficult, remain courteous; arguing, using obscenities, and making personal attacks will not get the account paid and may be construed as harassment.

When you make your first phone calls, you will probably feel ill at ease and you may mumble a bit. This discomfort will disappear with practice, as you learn how much personal satisfaction can be derived from making calls that result in payments. It is wisest to concentrate on the smaller accounts when you make your first calls and defer calling for larger accounts until you are confident and have learned how to make collection calls effectively.

Keep in mind that making phone calls costs money and takes time. Collecting the account on the first call is ideal, of course, and additional calls are simply

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**I**f a debtor's spouse will not relay your telephone messages, you can ask whether the debtor is still employed at the same firm — and say, "We'll take it from there."

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repetition. Review calls that did not result in payment: what words did you use (or fail to use)? Evaluate the techniques that seem to work. As a rule, never say anything on the telephone that you would not write in a letter. Following this simple rule should protect you from criticism (and worse). Keep the conversation on the proper level. Be persistent, but understanding; tactful, but direct.

After a short period, you should be able to determine from the debtor's tone of voice whether the account will be paid without any difficulty. Experience will allow you to judge which debtors will require additional pressure, and what actions will enhance the probability of collecting on a given account.

If the debtor will not commit to a payment schedule after two or three calls, you should consider taking legal action or engaging a professional collection service for recovery. Obviously, the account must be large enough to warrant an action of this type. If the account is small, it may be best to write the matter off as a bad debt. Because it is not possible to collect all accounts, you should sometimes be prepared to proceed to the next account, rather than waste valuable time attempting to resolve an account that is clearly uncollectable.

A few rules for making collection calls:

- Always have records of the account at hand when you make phone calls. Know what you are going to say, and say it clearly and with conviction.
- Control the interview: don't permit the conversation to digress. Pleasantries and small talk will not collect the account and they waste valuable time.
- Set a time limit on all calls — five minutes at most (you may find it helpful at first to use an automatic timer). You can spend more time on larger accounts than on smaller ones, because the returns are greater.
- Remain professional, not emotional. In particular, never speak in an abusive manner. To do so is to lose control of the interview and reduce the likelihood of collecting the account. Moreover, harassment is forbidden by law.
- If the debtor is not available when you call, ask the party who answers what his relationship to the debtor is.
- Speak only to the debtor or to a member of the debtor's immediate family (spouse or sibling). You may also leave a message with a son or daughter old enough to understand what you are saying.

- If an individual not in the immediate family answers, ask when the debtor will be available, and make the call then.
- Remember that the debtor is capable of terminating the conversation at any time by hanging up the receiver. You are more likely to be successful if you speak in a reasonably friendly manner.
- Never make collection calls for more than two hours at a time. Allowing yourself a one- or two-hour break between series of calls will improve your effectiveness.
- After each call, record the results of the call on the ledger card. Attempting to record results after making 15 or 20 calls can only lead to confusion and unnecessary repetition of calls.

When you reach the debtor, get right to the point. You might say, "My name is Robert Johnson and I am calling for Ace Hotel. We have billed you on your account for \$300 four times, and have had no response from you. I would like to know *right now* what arrangement you are going to make to pay the account in full." Always use the word "arrangement"; if you say "arrangements," you are implying that time payments can be made.

Then just wait for the debtor's response before saying another word. Very often, the debtor agrees to pay the account in full on the first call. If the debtor says he is having financial difficulties, ask why he did not tell you so. Why did you need to make a call to find out? This approach puts the debtor on the defensive. If the debtor tells you he is unemployed, *always* ask how long he's been without a job. If your account is four months old, and he has been unemployed only a month, ask why he did not pay you while he was employed. You are also allowed to ask the debtor to pay you from his unemployment benefits.

In any call to a debtor, ask whether he is still employed with the same company and make a note of his response (including the date).

To the extent possible, you should insist that the debtor repay the amount in a single payment, if that was your original agreement. It is better to remain flexible, however, than to sacrifice the possibility of payment by being unwilling to negotiate.

If payments are to be made in installments, always ask the debtor to make his first payment at once. If you establish a payment schedule, find out precisely when the debtor intends to remit the first payment — and repeat the date, to ensure he understands what you expect. Ask the debtor to send the payment to your attention. Advance the account in your files to three days beyond the due date — and if the debtor has not remitted by that time, call him immediately to find out why not. Even after receiving collection calls, some debtors ignore the situation, presumably in the hope that the account will be forgotten. Maintain a rigid schedule of phone calls,



especially on follow-up calls, and keep track of all calls you make in a chronological file or daybook.

Suppose you call a debtor and, reaching his spouse, learn that he is not available. Ask the spouse when the debtor will be available — and, if the hours are such that you cannot call him then, leave a message that he should call you. Calls of this type can be both frustrating and unproductive, because you may have no way to get beyond the spouse to the debtor; for example, the spouse may have incurred the debt and may refuse to relay your messages. This difficult situation is one that cannot always be resolved. You may ask whether the debtor is still employed at the same firm, and if the spouse says yes, say, “Thank you, we will take it from there.” This can be an effective tactic because the spouse is likely to relay this message, fearing that the debtor will be contacted at work. However, never *say* you are going to contact the debtor at his place of employment because this is forbidden unless you have written permission to do so. Implying that you will contact the debtor at work is strictly a psychological gambit whose success depends on the debtor’s fears about what you might do.

You should call not only debtors who have failed to remit *any* payment but also those who are making payments more slowly or in smaller amounts than agreed upon. Emphasize the terms of the credit agreement, reminding the debtor of the size of the payment required and the due date. Also remind the debtor who submits payment inconsistently or in reduced amounts that the service charges added to the

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## A word about banquets

You are especially vulnerable to collection problems in catering banquets or other special functions for private groups. Although the planners of a testimonial dinner may request your services in good faith, something always seems to go wrong: too few tickets are sold, the number of “no-shows” is high, the planners are unable to collect for all the dinners served. Especially if the group comprises prominent business people or other prestigious individuals, the hotel or restaurant manager often fails to obtain the information he needs to ensure full payment for the affair. The most important question, of course, is who is going to pay.

Before agreeing to cater a one-night function, obtain the full name of the organization sponsoring the function, the organization’s full address (determine whether the address is permanent or temporary), and the purpose of the gathering. To protect yourself from losses, ask the individual responsible for the function to sign a statement to the effect that he will assume liability for payment in the event of a default or any other problems related to the function. The statement should include the individual’s full name, home address, and home telephone number.

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## **R**emain flexible rather than sacrifice forever the possibility of payment by refusing to negotiate.

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account each month are increasing the amount he must ultimately pay. If you and the debtor agree to a new payment schedule, send a written notice confirming that future payments will be expected on or before the new due date.

You will find that some debtors make a payment on the first day of one month and another on the last day of the following month, claiming that they are paying as agreed. Remind them that a payment is due every 30 days, and that if they continue in this fashion, they may be two payments short each year and their service charges will be sizable.

A debtor making very small payments on the account can sometimes be induced to increase the size of the payment. Point out to the debtor how long it will take to pay the amount due. You might say, for example, “At your present rate of payment, it will take you five years (or 60 months) to pay in full.” Simple recognition of the time involved often prompts a debtor to increase the size of his payments. You have nothing to lose by pointing this out, and you stand to gain considerably. Many debtors believe — mistakenly — that if they make *any* payment on an account, they cannot be sued for the balance. Consult your attorney for advice on handling situations of this type.

In making telephone calls pertaining to delinquent accounts, you will need to make a good number of off-the-cuff judgments. There is no standard answer to all collection problems. Each debtor has a unique personality; some react badly to pressure, while others will respond to it by paying promptly. It is important to remember that successful collection often requires negotiation. If a debtor is genuinely unable to pay the account at the time you call, insisting that he pay will not produce a check. In fact, being too rigid may lead the debtor to refuse to pay an account he would have been happy to settle as soon as he was able. In such cases, if the amount due is too small to justify legal action or professional collection efforts, you have failed completely in your objective.

Be flexible: take a little, and sometimes give a little. This approach is more productive in the final analysis.

## Disputed Accounts

If a consumer disputes a debt, ask him to communicate all the details of the dispute to you in writing. If he does so, you have an opportunity to take steps toward a resolution of the dispute. If he does not, however, he has not abrogated his rights and his

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**S**ome debtors have no intention of paying and there is no chance of recovering any money from them: they are judgment-proof.

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failure to respond is not legally considered an admission of liability. Send him written notice that you will wait 30 days for him to attempt to resolve the matter in dispute. If he does not respond within that time, you may resume collection efforts (you still won't know whether his complaint was legitimate, but you have no alternative but to proceed).

### **The Kinds of Debtors and Debts**

Not all debtors are incorrigible deadbeats. Some have fallen into financial difficulty through no fault of their own; others are simply forgetful (sending statements to these debtors on a regular basis usually produces results). There are four major categories of delinquent payers: the victim of circumstance, the staller, the slow payer, and the credit thief.

- **The victim of circumstance:** Unemployment, personal illness, illness in the family, fire, automobile accident, and other circumstances may constitute valid reason for nonpayment of an account. In such cases, be patient; the debtor will generally come up with the money as soon as he is able.

If a debtor has experienced misfortune, bear in mind that pressing the issue is not likely to resolve the matter, and will only antagonize the debtor. Adopting a hard-nosed attitude can provoke the debtor's anger and thus reduce your chances of resolving the account at a later date. Instead, advise the debtor that you will advance the account in the files and expect to receive payment when the debtor's circumstances improve. If you are understanding, the debtor may well make payments to you before paying his other creditors.

If a debtor tells you he is unemployed, ask him how long this has been the case. If the age of the account far exceeds the length of his unemployment, you should obviously exert pressure for payment. This ploy is especially common among seasonal workers — for example, people in the building trades. Such workers may claim during the “off” season that they cannot pay because they are receiving unemployment benefits. However, their earnings during the building season are substantial; unemployment is cited only as an excuse to forestall payment. In such cases, push for collection of the debt.

- **The staller:** Some debtors voice all kinds of complaints about real or imagined problems in an attempt to stall payment. The best way to cope with such debtors is to listen to all they have to say, and then ask for your money. You will be surprised at the

number of times this straightforward approach produces results — as opposed to arguing, which only extends the conversation unproductively. If the debtor still complains, tell him to put his complaints in writing within 15 days so that you may examine the matter and reach some conclusion. If the matter must eventually be referred for collection, you will at least have a written record to present.

If the debtor's complaint is valid, take steps to correct the problem at once — then send the debtor a letter explaining the corrective measures taken and asking for payment in full of the balance due.

- **The slow payer:** It is difficult to induce a slow payer to settle his account in full. If you exert some pressure, he will usually send a payment, but most often it is a minimum amount used as a delaying tactic. Accounts of this nature can be extremely expensive to handle. If the amount due justifies it, you can always resort to legal action, and you are able to notify the debtor that such action is being considered.

- **The credit thief:** Some debtors who execute transactions on credit have absolutely no intention of paying. They are so deeply in debt, and have so many judgments against them, that there is virtually no possibility of recovering any money from them. They are considered judgment-proof because they have little or no income and they own no property that could be attached to satisfy a judgment. The only way to avoid extending credit to such individuals is to obtain complete information at the time of application and verify all references.

When you learn that a debtor is a credit thief, and your efforts to collect fail, accept that the account is a bad debt. Do not squander valuable time on vain efforts to collect. Instead, learn from your mistake and pay more attention to the credit application in the future.

Common sense should govern your actions, whether you are dealing with a credit thief or simply an absentminded individual.

### **The Check Is in the Mail**

Many debtors will tell you their accounts are paid. Some are telling the truth; others are just stalling. It is difficult to resolve a situation in which the debtor maintains he has paid because you must always entertain the possibility that you failed to record a payment.

To determine whether the debtor is bluffing or has perhaps made an honest error, you should ask him for proof of payment in the form of either a receipt or a cancelled check. If the payment was allegedly made by check, ask for a copy of both sides of the check. Even if it was cashed, a copy of the front of the check can prove nothing unless the bank marked it “Paid.” Because some debtors write checks for the sole purpose of pretending they've made

payment, obtain a copy of the check's reverse side, upon which the bank's cancellation mark will appear if the check was cashed.

If the consumer refuses to produce documentation of the account's payment, and you have examined your books and records carefully, you have only one recourse: turn the matter over to your attorney for his evaluation and suggestions for the resolution of the account. Be certain to advise him that the consumer claims he has paid. Legal action should be taken only when the amount of the account warrants the time and effort required to resolve it.

### **The Rubber Check**

Procedures for handling returned checks vary from state to state, so you should consult your attorney for advice in this area. The following paragraphs offer general guidelines for dealing with bad checks.

If a check returned to you is marked "Insufficient Funds," try to contact the writer of the check by phone. He may be able to offer a logical explanation for the check's return and you may be able to redeposit the check. If you are unable to reach the debtor by phone, send a notice signifying your intent to redeposit the check. The bank will have sent a notice to the debtor that the check was not honored.

When a check is returned a second time, it is usually marked "Protested — Do Not Deposit." This situation is obviously a collection problem, and you should immediately seek the advice of your attorney on how to proceed. In some states, getting payment on a returned check is a simple matter, while in others it is extremely complicated.

### **When a Debtor Goes Bankrupt**

If you receive a court or legal notice that a debtor is filing a petition in bankruptcy, you are required to cease all collection efforts aimed at the debtor. If you receive such a notice directly from the debtor, either in writing or by phone, ask immediately what attorney is representing the debtor. Send the attorney and the court an itemized statement of the account by certified mail and request a return receipt.

Never take for granted that a bankruptcy petition will be filed simply because the debtor has told you so. Many individuals who intend to file never go through with the bankruptcy action; others will tell you they are going bankrupt just to stall your collection efforts. If you are unable to determine the name of the debtor's attorney, proceed with collection efforts until this information can be obtained.

You are not permitted to begin or to continue collection efforts after you have been notified that a petition in bankruptcy is to be filed. If the account is sizable, refer the matter to your attorney for legal representation.

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## **D**ebtors who cite unemployment as their reason for not paying should always be asked how long they've been out of work. A seasonal worker may use unemployment only as an excuse.

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If the debtor filing for bankruptcy is still doing business with you, you are prohibited from adding the unpaid balance to any new account.

Certain provisions in the bankruptcy laws permit a petitioner to continue operating his business. Chapter XI\* permits the debtor to try reorganizing the business, in the hope he will achieve solvency and make restitution to his creditors. In such cases, a court representative oversees the petitioner's business and forwards money to creditors if and when it becomes available; creditors can no longer communicate with the debtor, and must direct all communications to the court.

### **The Way of Judgments**

A judgment is a legal record issued by a court of proper jurisdiction. It avers that a given sum is indeed owed to you by the debtor. Many people assume that, when a judgment is awarded, the total due will automatically be paid. In fact, many judgments are never paid. The process of collecting a judgment can be long and time-consuming, requiring a number of legal steps. Consult your attorney for advice on the procedures required to collect on a judgment.

The length of time that a recorded judgment remains in effect varies from one state to the next (see the exhibit on the following page). After the specified period has elapsed, a judgment is no longer enforceable and you have no means to effect collection — although the term of a judgment can be extended in most states for a small fee.

A recorded judgment is a lien in most states, entailing a legal attachment of real estate owned by the debtor. In other words, the debtor generally cannot transfer, sell, or otherwise dispose of the property without paying the lien or judgment. If the state in which you reside is one in which garnishment is permitted, you can attach the wages of the debtor to accomplish collection of the debt.

The institution of a legal action for collection of a debt must be accomplished within the time constraints established by the laws of your state. You cannot begin any action after the statute of limitations has expired, and you may face severe penalties

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\*For a discussion of laws pertaining to bankruptcy, see: Frank L. Sullivan, "Bankruptcy: How to Avoid It if You Can, and Live with It if You Can't," *The Cornell Hotel and Restaurant Administration Quarterly*, 18, No. 3 (November 1977), pp. 6-12.

# Summary of collection laws

Location	Statute of Limitations				General Garnishment Exemption*
	Open Accounts Years	Contracts in Writing Years	Domestic Judgments Years	Foreign Judgments Years	
Alabama	3	6	20	20	See federal law; except on credit sales, greater of 80% or disposable earnings = to 50 × fed. min. hourly wage, per week.
Alaska	6	6	10	10	75% of employee's weekly income, or up to \$114 per week of disposable income, whichever is greater.
Arizona	3	6	5 Add'l on request	4, or shorter period dictated by country	See federal law.
Arkansas	3	5	10	10	\$500 head of family; \$200 single, includes personal property except clothing.
California	4	4	10	10	See federal law. Exemptions for non-necessity items.
Colorado	6	6	20	6	See federal law.
Connecticut	6	6	21	No provision	75% disposable earnings each week, or 40 × fed. min. hourly wage.
Delaware	3	3	No provision	No provision	85% of wages.
District of Columbia	3	3	12	Foreign statute applies	See federal law; except 90% of 1st \$200 gross wages per month, 80% on excess of \$200 & under \$500.
Florida	4	5	20	5	See federal law; except 100% head of household.
Georgia	4	6	7	5	See federal law.
Hawaii	6	6	10	4	95% of 1st \$100, 90% of 2nd \$100, 80% gross wages in excess of \$200 per mo.
Idaho	4	5	6	6 (May renew)	See federal law.
Illinois	5	10	20	5	\$65 head of family, \$50 single, per week, or 85% gross wages, whichever greater, but no more than \$200.
Indiana	6	10 money 20 other	20	20	75% of disposable earnings for work week in excess of 30 × fed. min. hourly wage.
Iowa	5	10	20	20	See federal law.
Kansas	3	5	5	5	See federal law.
Kentucky	5	15	15	15	See federal law.
Louisiana	3	10	10	10	75% disposable earnings per work week, \$70 min.
Maine	6	6	20	20	100%. Money judgment: greater of 75% or amount by which week's earnings exceed 30 × fed. min. hourly wage.
Maryland	3	3	12	12	Greater of 75% or amount = to \$120 × no. of wks. in which wages due were earned; except in Caroline, Worcester, Kent & Queen Anne's Counties (see federal law). Up to \$400 in property, \$200 of which may be in money.
Massachusetts	6	6	20	20	\$125 wk.
Michigan	6	6	10 (renewable)	10	See federal law.
Minnesota	6	6	10	10	Greater of 75% or amount = to 40 × fed. min. hourly wage.
Mississippi	3	6	7	7	See federal law.

\*Federal law exempts from garnishment 75% of disposable earnings per work week, or an amount = to 30 × federal minimum hourly wage, whichever is greater. Some state laws still on the books are listed below, but where federal law provides larger exemption, it supersedes the state law.

Location	Statute of Limitations				General Garnishment Exemption*
	Open Accounts Years	Contracts in Writing Years	Domestic Judgments Years	Foreign Judgments Years	
Missouri	5	10	10	10	See federal law; except 90% of week's net pay, head of household.
Montana	5	8	10	10	See federal law.
Nebraska	4	5	5 (renewable)	5	Greater of 75% of disposable earnings (85% if head of household), or 30 × fed. min. hourly wage.
Nevada	4	6	6	6	See federal law.
New Hampshire	6	6	20	20	50 × fed. min. hourly wage.
New Jersey	6	6	20	20, or shorter period dictated by country	\$48 wk. min.; 90% if earnings \$7500 a year or less.
New Mexico	4	6	7	7	Greater of 75% or amount each wk. = to 40 × fed. min. hourly wage.
New York	6	6	20	20	90% of earnings in last 60 days, except 1st \$85 wk. wholly exempt.
North Carolina	3	3	10	10	100% of last 60 days' earnings for family support. Garnishment only by political subdivisions for taxes, ambulance fees, etc.
North Dakota	6	6	10	10	Greater of 75% or amount each wk. = to 40 × fed. min. hourly wage. Personal property, \$1500 head of household, \$150 single.
Ohio	6	15	21	15	See federal law. Garnishment limited to once a month per employee.
Oklahoma	3	5	5 (renewable)	3	See federal law.
Oregon	6	6	10	10	75% of disposable earnings or 40 × fed. min. hourly wage.
Pennsylvania	6	6	No provision	No provision	100%.
Rhode Island	6	6	20	20	See federal law.
South Carolina	6	6	10	10	100%.
South Dakota	6	6	20	10	100% of last 60 days' earnings for family support.
Tennessee	6	6	10	10	Greater of 50% or \$20 per wk. head of household, max. \$50; greater of 40% or \$17.50 per wk. single, max. \$40.
Texas	2	4	10	10	100% of wages.
Utah	4	6	8	8	\$92 of disposable earnings for wages paid weekly, \$184 if paid bi-weekly, \$199.33 if paid semi-monthly, \$398.66 if paid monthly.
Vermont	6	6	8	8	\$30 wk. + 1/2 of earnings in excess of \$60 per wk.
Virginia	3	5	20	10	See federal law.
Washington	3	6	6	6	Greater of 75% or \$64 per wk. (40 × state min. hourly wage).
West Virginia	5	10	10	10	80% of wages (\$20 per week min.) due or to be due within one year of issuance of execution. Personal property, \$1,000 for head of household.
Wisconsin	6	6	20	10	Greater of 75% net pay, or 30 × fed. min. wage for each full week of pay period. Special dependent exemption.
Wyoming	8	10	5	5	50% of last 60 days' earnings for family support. See federal law for consumer credit sale, lease or loan.

Source: U.S. Chamber of Commerce, 1977

if you commence collection efforts on an "outlawed" debt. However, this eventuality need not concern you if you practice effective credit management, because collection efforts should begin long before the statute of limitations becomes a concern.

The time periods indicated in the exhibit are generally dated from the last day of payment on the account or from the last day of service.

### **When the Debtor Disappears**

Professional collectors refer to efforts aimed at finding relocated debtors as "skip-tracing." Locating a debtor who has moved from his original address is an art requiring considerable patience, a little luck, and in some instances the detective abilities of Sherlock Holmes. Skip-tracing also requires tact, for you will be in contact with people who you hope will help you locate the "skip." Nonetheless, you should make an all-out effort to track down relocated debtors — or accept the considerable cost of leaving numerous accounts unpaid.

The procedures outlined earlier in regard to the credit application provide a logical starting point for skip-tracing. Begin by calling the telephone number given on the credit application. If the debtor has moved within a reasonably small area, he may have retained the phone number when he changed his address. If a new number has been assigned, the telephone operator will often give you the new number automatically. If not, call for directory assistance and ask whether a new number has been assigned to the debtor. You should specifically advise the operator that it is a new number you seek.

If these calls yield no information, call the employer listed on the credit application. Remember that you are not allowed to mention the debt to the employer, or to anyone who answers your call. When you reach a member of the organization who may have a record of the erstwhile employee's address, your remarks should be limited to the following: "My name is John Spelvin, and I am calling for Spelvin Caterers. I am attempting to verify employment for Mr. George Smith. Is he still employed with you?" If the answer is affirmative, ask to check the address on record at the place of work against the address recorded on the application. If you are asked to state the purpose of your call, merely reply, "It is a personal matter." If the debtor is still at the place of employment, but the employer has not been informed of a change of address, you may forward mailings to the debtor at the place of employment. Adhere to the rules governing mailings: mark the envelope "Personal" and include no exterior indication that the contents relate to a debt.

Some companies will not give out information on the phone, and require that you send a letter formally requesting information. If this is the method

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## **Locating a debtor who moves is an art that requires patience, a little luck, and in some cases the abilities of Sherlock Holmes.**

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you must use, you should phrase the letter as follows:

May we please verify the employment of the person named below:

Mr. James Jones  
1234 Main Street  
City, State, Zip

The address indicated is the one we have on file. If you have a more recent address for Mr. Jones, we would appreciate your so advising us.

Thank you for your cooperation. A stamped, self-addressed envelope is enclosed for your convenience in replying.

It may be useful to call the credit references listed on the credit application. Other creditors may have learned the debtor's new address. Even when talking to other creditors, however, do not say you are attempting to locate the party in the matter of an unpaid bill. If you learn the debtor's new address, attempt to reach the debtor by telephone. If you are unable to contact him, send a statement to the new address in an envelope with "Address Correction Requested" imprinted on it. This device insures that the invoice is delivered and allows you to verify the address, for if the Post Office does not return an address-correction card, you may assume that the debtor has received the billing.

If the debtor's children were enrolled in a local school, call the school to ask whether they have been informed of a change of address for the children. Voting lists are another good source of information.

If you are a member of a local credit bureau, see whether the debtor's new address is on file at the bureau — and, if not, ask to be notified when the bureau learns of the new address. In the process of moving, many people purchase furnishings and other household goods, and these transactions require credit. If a credit check is made, a new address and a new place of employment may be identified.

A "criss-cross" telephone directory may be a good investment if one is available in your area and if you have a substantial number of accounts. This type of directory contains a wealth of information. All named listings are in alphabetical order; all streets are listed in numerical order; the names of tenants are given; tenant ownership of the residence is indicated; and telephone numbers are included. A criss-cross directory helps you call the persons residing on either side of the debtor's residence. These individuals may be able to give you the debtor's new address or phone number. Even learning the city or

state to which the debtor has moved is a help — or learning that the debtor has changed jobs. When you have identified the city to which the debtor has gone, call for directory assistance, advising the operator that the number you seek is a new listing. If no new

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## **P**erhaps most troublesome is the “hanging account” with a friendly debtor.

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number has been issued, try again in one or two months; it can take that long for a new subscriber to be assigned a telephone number. Whenever you do get a phone number, call the debtor person-to-person — and be sure to ask for his new address.

Suppose you have taken all the foregoing steps and have not been able to trace the debtor. File the account and, when new city directories are available, check to see whether the debtor is listed. Your local library will have copies of the directory. You can also consult directories going back two or three years for helpful information.

In applying each skip-tracing technique, record on the ledger card the steps you have taken, the dates, and the results.

### **The Hanging Account**

A “hanging account,” as described in this section, is extremely expensive to carry on the books and can be the most difficult account to resolve.

A hanging account often involves a debtor who is on friendly terms with the creditor. The creditor feels uneasy about mentioning the unpaid balance, for the debtor is still doing business with the company, and there is a natural reluctance to interfere with a personal relationship. In many instances, the creditor fears the possible loss of the debtor’s friendship or business.

It is a mistake to assume that simply because a customer continues to do business with you, he will eventually pay the outstanding balance on his account. Many creditors are inclined to allow familiar customers to build up their accounts this way, even though the unpaid balance at the end of the month or year is substantial.

The hanging account amounts to a “no-win” situation for the creditor — especially when it comes time to ask that the account be paid. The debtor, on the other hand, suffers no compunction about running up the account, and always acts highly indignant when the creditor sees fit to ask for the amount due to him. The debtor may interpret the creditor’s request for money as an affront to his integrity.

The longer a hanging account remains unpaid, the less apt the debtor is to recognize the total amount due, and the more likely he is to decide that there must have been errors in the creditor’s accounting; after all, the debtor *knows* the account is not that large.

A hanging account requires hours of arguing and bickering, poring over ledger sheets, and discussing service charges. Records of the account inevitably include charge slips without a signature and without clear indication of the goods purchased, so the creditor may need to remember transactions that took place two or three years ago in defending his records to the debtor. Because many of the transactions can-

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## **A** hanging account means hours of bickering and poring over ledger sheets.

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not be explained to the debtor’s satisfaction and because the creditor does not have adequate documentation of the purchases to support his claims, the end results of hanging accounts include lost money and lost customers.

If these were not sufficient reasons to avoid hanging accounts, consider the cost of carrying such accounts on the books year after year. Suppose that a customer owes you \$6,000 at the beginning of the year, purchases an additional \$3,500 worth of goods and services during the year, and pays you \$3,000 on his account during that time. The unpaid balance to be recovered is \$6,500 — in fact, more than the amount owed you at the beginning of the year. Debts accumulate quickly in accounts of this type, but because the creditor receives *some* payment, he is rarely concerned about the balance. The creditor may also find the hanging account expensive in lost service charges. This type of account is not usually conducive to adding such charges, and because the creditor may not issue statements on a regular basis, he will often neglect to calculate the applicable service charges. Moreover, even if service charges *are* added, they may never be recovered if the balance is not paid.

If any misunderstanding should arise between debtor and creditor in respect to the amount owed, the creditor generally finds that his records of the account are inadequate. The informality of hanging-account transactions complicates the task of recovering the full balance due the debtor.

Consider some of the circumstances that can render a hanging account uncollectable:

- **The death of the debtor:** How do you explain to an attorney and the probate court the amount of

money the debtor owed you if your only records are incomplete, unsigned sales slips? It is unlikely that you will be able to support your claim for the unpaid balance with such flimsy evidence.

- **The debtor sells out**, goes bankrupt, or goes out of business for another reason: How do you protect your interests? Your informal handling of a hanging account will make it difficult to establish the amount due. If litigation is required, you will incur additional expenses for attorneys and court fees, even if the legal action is successful (which is not often the case).

- **The death of the creditor:** If you die, the procedures required to settle accounts will cost dearly. The Internal Revenue Service will tax the entire amount listed on the books as "Accounts Receivable," even though many of the accounts will never be paid. Most of the accounts will be turned over to an attorney for collection at a cost of 33⅓ to 50 percent of the receivables. It is not uncommon to find an estate of \$500,000 in accounts receivable reduced to \$100,000 after estate taxes, probate, and collection costs.

You can resolve some of your existing hanging accounts by sending debtors a letter of the type shown below. The letter should be typewritten, signed, and

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**I**t is a mistake to assume, simply because the debtor is still doing business with you, that he will eventually pay the outstanding balance on his account. In fact, the balance tends to grow continually.

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sent in a plain white envelope. There should be no indication on the envelope that it is being sent by your company; using a stamp rather than a postage-meter imprint, and even mailing the letter from a town other than the one in which your business is located, will help ensure that the debtor at least opens the letter out of curiosity. The letter informs the debtor, in a manner that does not offend, that you perceive his account as a problem.

Amount of the Account

Dear \_\_\_\_\_ :

This letter is of vital concern to us, so please give it your careful consideration. We wish that we could visit with you, and explain this matter in person; however, time does not permit a personal call.

Our accounts receivable have grown so large that we have not been able to stay within our credit terms with (name of supplier or bank). Their terms with us

are 10 days. Our terms with you specify payment by the tenth of the month following the receipt of a statement — in other words, a maximum of 40 days. This means that we must pay a staggering sum during the interim: a sum that we cannot afford if our customers allow their accounts to go past the due date of our credit terms.

We are writing to explain the tremendous load that we must carry, so that you will have a better understanding of our situation, and we ask you to make your payments promptly — in accordance with the time limits of our extension of credit to you.

Very truly yours,

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This letter essentially asks the debtor to bring his account up to date. If you followed the suggestions regarding typing and stamping the envelope, you can be reasonably sure that the debtor opened the envelope, and any debtor who does not respond to the letter in some fashion should be regarded as a possible problem.

If any debtor objects to the letter, say, "We didn't *want* to send it, but our supplier (or bank, or any other third party you might name) told us we had to because they said our accounts receivable were too high." You might also make the following additional comments: "You know you owe the account, I know you owe the account, and *I* know you will pay, but *they* (the bank or supplier) are in the driver's seat. So why don't you make an arrangement with me to pay something each month on the balance we now have, and pay for any new purchases? That way, you'll gradually reduce the balance, and I can get these people off my back, and yours too. Okay?" Then proceed to negotiate the payments.

Always mention that you will expect a payment each 30 days on the past-due amount because your banker or supplier will be in every month to check the accounts. You thereby imply that any further ac-

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**D**epts accumulate quickly in an account of this type — and the longer it remains unpaid, the less likely the debtor is to believe he owes the total amount due.

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tions to be taken are out of your hands. In other words, you shift the blame to someone else and preserve your image as a friend who is willing to help.

You should be aware that many debtors deliberately take advantage of creditors' willingness to extend credit on a hanging account. It's a means of

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**O**ut of fear of offending the debtor and losing the debtor's business, the typical creditor actually seems reluctant to ask for his money. What he fails to realize is that, if he does not ask for it, he has lost not only the customer — who will generally take his business elsewhere if his unpaid balance is substantial — but his money too.

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advancing their own business enterprises at the expense of yours — often without incurring any additional cost for failure to pay.

### **If You Need an Attorney**

Most attorneys do not perform collection work as a regular part of their practice. If there is an attorney in your area who specializes in collection work, he is the individual most qualified to help you handle collection efforts.

If you are already represented by an attorney in the conduct of your business, as a matter of courtesy ask him whether he can handle your collection problems. Do not expect him to take on this added responsibility as a favor; if he is in general practice, he almost certainly does not have the time to provide complimentary services, and your accounts will be neglected in favor of work that is more lucrative to him.

Do not refer \$20 accounts to a collection lawyer; they only waste the attorney's time for a negligible reward. Accounts of at least \$100 justify a professional collection effort. Expect to pay a commission of 33⅓ to 50 percent of the amount due, varying with the amount collected and the age of the accounts.

When you first contact the attorney, ask him what he considers the smallest acceptable account. As a practical matter, he must apply as much effort to collect on a \$50 account as on a \$500 account, and the returns to you and to him are much smaller on the \$50 account.

### **Selecting a Collection Agency**

As an alternative to using a collection attorney, you can engage a professional collection agency. An agency is paid only for accounts actually collected; there is no charge for unsuccessful efforts.

A collection agency can also refer an account to a collection attorney for legal action in the event its efforts fail. By doing business with a collection

agency, you also have the availability of a collection attorney. Finally, a collection agency will generally be able to collect some of your smaller accounts. Commission fees are higher on small accounts, but any amount you receive is better than nothing.

The representatives of a collection agency will be entrusted with your money, so it is essential that you learn as much as you can about an agency before you select one. How long has the agency been in business? How many employees does it have? Go to the agency's office and examine the physical layout of its facilities. Ask for references, and check them. You should engage an agency whose track record and employees inspire your confidence.

### **Conclusion**

No one enters a place of business and says, "Give me that, but I am not going to pay for it." Instead, the customer may say, "Bill me the first of the month," or, "I'll send you a check." Unfortunately, these promises are often broken.

Far too many members of the business community are guilty of laxity in extending credit. They fail to ask for the money due them, and they fail to examine their accounts receivable on a consistent basis. This unsystematic approach to credit can entail substantial losses.

The typical creditor actually seems afraid of asking for his money, out of fear of offending the debtor and losing the debtor's business. What he fails to realize is that, if he does not ask for his money, he has not only lost the customer — who will generally make purchases elsewhere if his unpaid balance is substantial — but his money too.

The most important component of credit management is the painstaking evaluation of the credit application. Routine monitoring of your accounts receivable and a regular billing series will also prevent small problems from developing into large ones. When these procedures fail, applying the techniques set forth in the foregoing pages will help you recover the money that is due you. □