Protecting Your Assets: A Well-Defined Credit Policy Is The Key

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Protecting Your Assets: A Well-Defined Credit Policy Is The Key

Abstract
In - Protecting Your Assets: A Well-Defined Credit Policy Is The Key – an essay by Steven V. Moll, Associate Professor, The School of Hospitality Management at Florida International University, Professor Moll observes at the outset: “Bad debts as a percentage of credit sales have climbed to record levels in the industry. The author offers suggestions on protecting assets and working with the law to better manage the business.”

“Because of the nature of the hospitality industry and its traditional liberal credit policies, especially in hotels, bad debts as a percentage of credit sales have climbed to record levels,” our author says. “In 1977, hotels showing a net income maintained an average accounts receivable ratio to total sales of 3.4 percent. In 1983, the accounts receivable ratio to total sales increased to 4.1 percent in hotels showing a net income and 4.4 percent in hotels showing a net loss,” he further cites.

As the professor implies, there are ways to mitigate the losses from bad credit or difficult to collect credit sales. In this article Professor Moll offers suggestions on how to do that.

Moll would suggest that hotels and food & beverage operations initially tighten their credit extension policies, and on the following side, be more aggressive in their collection-of-debt pursuits.

There is balance to consider here and bad credit in and of itself as a negative element is not the only reflection the profit/loss mirror would offer.

“Credit managers must know what terms to offer in order to compete and afford the highest profit margin allowable,” Moll says. “They must know the risk involved with each guest account and be extremely alert to the rights and wrongs of good credit management,” he advocates. A sound profit policy can be the result of some marginal and additional credit risk on the part of the operation manager.

“Reality has shown that high profits, not small credit losses, are the real indicator of good credit management,” the author reveals. “A low bad debt history may indicate that an establishment has an overly conservative credit management policy and is sacrificing potential sales and profits by turning away marginal accounts,” Moll would have you believe, and the science suggests there is no reason not to.

Professor Moll does provide a fairly comprehensive list to illustrate when a manager would want to adopt a conservative credit policy. In the final analysis the design is to implement a policy which weighs an acceptable amount of credit risk against a potential profit ratio.

In closing, Professor Moll does offer some collection strategies for loose credit accounts, with reference to computer and attorney participation, and brings cash and cash discounts into the discussion as well. Additionally, there is some very useful information about what debt collectors – can’t – do!

Keywords
Steven V. Moll, Bad debt, Accounts receivable ratio, Credit management, Collections, Consumer Credit Protection Act, Truth in Lending Act, Fair Credit Billing Act, Fair Debt Collection Practices Act, FIU, Beverage

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Protecting Your Assets:
A Well-Defined Credit Policy Is The Key

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Bad debts as a percentage of credit sales have climbed to record levels in the industry. The author offers suggestions on protecting assets and working with the law to better manage the business.

In this society, people are more cognizant of their legal rights than ever before. Litigation has become a way of life for many hotels, restaurants, and clubs.

Because of the nature of the hospitality industry and its traditional liberal credit policies, especially in hotels, bad debts as a percentage of credit sales have climbed to record levels. In 1977, the accounts receivable ratio to total sales for hotels showing a net income maintained an average of 18.7 percent. In 1983, the accounts receivable ratio to total sales increased to 22.8 percent for hotels showing a net income and 24.6 percent for hotels showing a net loss. The credit terms a hospitality establishment offers to guests must become more aggressive in today's highly competitive business environment.

To combat these losses, controllers of these various organizations must become more aggressive in implementing policies which tighten the extension of credit and make the collection of debts a more aggressive exercise.

Credit managers must know what terms to offer in order to compete and afford the highest profit margin allowable. They must know the risk involved with each guest account and be extremely alert to the risk involved with each guest account. They must know the highest profit margin allowable. They must know what terms to offer in order to compete and afford the highest profit margin allowable.

Credit managers must know what terms to offer in order to compete and afford the highest profit margin allowable.
The business is trying to establish new markets and

The environment is extremely competitive.

The inventory is very large.

The market is declining.

To the next season.

The business is reaching the end of the season and there

would be.

Factors which might indicate the necessity for a liberal credit policy.

Where business cannot be built up immediately.

Demand for services is higher than the ability to serve.

Business is shrinking rapidly.

An order which has been made requires extensive changes.

The economic environment is uncertain.

Factors which might indicate the necessity for a conservative credit policy would be:

A company’s profit margin is not as healthy as it should be.

The real measure of a good credit manager is not his or her ability to

build sales volume and absorb some credit losses through the sales

management policy and is controlling potential sales and profit by

minimizing bad debts.

A few bad debts is not the real indicator of good credit management.

The real indicator of good credit management is the ability to pay off the debt.

The credit manager must maintain high

ability to pay and, therefore, the hotel, restaurant, or club must suffer.

Overhead is so high that the business must maintain high

across.

The business is suffering from new markets and

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Credit Policies Should Be Implemented

The implementation of a credit policy which suits a business' needs is not difficult. The first step is to determine the number and types of risk categories for the establishment. A manager would monitor the amount or degree of risk within each category by studying annual sales and bad debt losses for each. New accounts would be classified on a "guesstimate" basis according to the information available.

It is imperative, as with all financial information, to have the account classifications up-to-date and timely. Whatever policy a establishment adopts, it is important to keep it flexible. The economic environment in which all business operates is extremely volatile, and what was conservative today may be liberal tomorrow. An excellent guide to follow is a company's records for total sales and credit sales.

Even though a credit policy accepts a certain percentage of high risk accounts and a business may suffer bad debt losses, each individual loss should be treated as an unforeseeable mistake. Never grant credit without having a reasonable certainty that the guest has the ability and desire to pay. The amount of reasonable certainty of a guest's ability to pay is a result of investigation of that guest. Management should take the time to perform a credit check of his or her financial statements or should query a credit bureau. This will show if the guest has shown steady financial growth and profits and also how much the guest will be able to pay.

Finally, it is important to research the moral fiber of the guest, the most difficult aspect to investigate because management is trying to discover the guest's personal reputation. This data is available from a number of sources. Much can also be learned from a personal interview of the guest and from guest-supplied references or credit agencies. Reliance on a Dun and Bradstreet credit rating is another popular method. Other sources might be accountants, lawyers, or banks. The source chosen depends upon the credit information requirements.

The most reliable source of information about the guest is a personal impression. It is a good idea to meet the guest, if possible. A good color photograph of the guest is also helpful. The guest can be shown the products or services of the establishment and can be asked about his or her purchasing pattern. If the guest is a potential client, a letter of introduction should be sent to the potential client. This letter should contain a description of the guest's past transactions and the terms of the credit agreement.

In the hospitality industry, this causes thousands of business failures each year. The cure for this unhealthy position is an aggressive collection policy which is set by management. High powered, aggressive collection techniques are the only effective way to improve the cash flow of a business. The amount of delayed accounts receivable is an indication of the business's creditworthiness.
have their drawbacks. They do bring in the needed cash, but they could also lose customer confidence and sales volume in the long run.

**Collection Strategy Should Be Flexible**

Collection strategy, therefore, should be kept flexible. Detecting late payments requires constant checks through the receivables file. A systematic aging of receivables at frequent intervals is necessary. Computer assistance in this area facilitates this mundane function with speed and accuracy, freeing personnel to perform the "people functions" of actually collecting the money.

Management should develop an appropriate collection policy so that the system, once developed, should alert management to accounts as they become overdue, reminding them of previous collection efforts, and informing them of the next step that should be taken. A letter of credit explanation, which should go to every new guest, would streamline teaching sales personnel and guests. The detail of the letter depends upon the type of guest and the nature of his or her business with the establishment. A willingness to help, the ability to serve, and integrity should be emphasized.

A more serious problem is the delinquent debtor who suffers a shortage of funds or a lack of desire to fulfill an agreement. These debtors fall into the delinquency collection category. Disasters or a strike may cause a shop to become a delinquent debtor. Where do you start collecting when there is no agreement? These debtors must be handled with compassion and understanding. The delinquent debtor, who is not just delinquent but is suffering from a serious financial emergency, should be approached differently. A willingness to help, the ability to serve, and integrity should be emphasized. This is especially true when the delinquent debtor is the result of an emergency, such as a fire or a strike.

Debtors who suffer seasonal slumps are a problem. When business is strong, cooperation and expression of concern for the debtor's situation can generate cooperation and expression of concern for the debtor's situation can be generated. If a debtor who is not regularly paid is met to be very lengthy, offering cooperation and expression of concern for the debtor's situation can be generated. If a debtor who is not regularly paid is met to be very lengthy, offering understanding and assistance can often resolve the problem. A sympathetic attitude of the debtor's situation can be generated. If a debtor who is not regularly paid is met to be very lengthy, offering understanding and assistance can often resolve the problem. A sympathetic attitude of the debtor's situation can be generated. If a debtor who is not regularly paid is met to be very lengthy, offering understanding and assistance can often resolve the problem. A sympathetic attitude of the debtor's situation can be generated. 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ness is booming, they pay their bills on a timely basis. When the slump occurs, you wait and wait. These types of debtors can develop into prime accounts if given time Management must be alert to the seasonal debtor who is severely undercapitalized and is probably not going to survive the off-season.

Attorneys Can Be Useful

There will be times when the credit department discovers the reason a guest has fallen behind in payments is because his or her business is going bankrupt. This is an urgent situation. Management must do everything in its power to collect the debt immediately. It is important to use the strictest methods available; the establishment's attorney should be consulted.

Another situation where use of the attorney would be necessary is in cases of fraud. When this occurs, gather all documentation and evidence of the fraud but discuss the case with no one because it may open management and the establishment to charges of slander and libel. Once the evidence has become definite, turn the entire affair over to company attorneys.

Many circumstances have been discussed as to why guests fail to pay their bills on time. There are just as many reasons why they would take an unearned discount. It is possible they misunderstood the terms or discount procedures. If taken innocently, a simple note will solve the situation. If, however, guests took the discount deliberately, they are testing the business and the way management reacts will be the determining factor for future dealings.

When responding to such a challenge, have a variety of strategic options prepared. Management may be lenient and allow the discount; it may also be lenient but firm, allowing the discount this time but sending a letter stating it will refuse any future attempts at taking the discount. Management may also strongly adhere to its policy and refuse the discount.

There are strengths and weaknesses to each of these options. If a business really needs volume, allowing the discount may be the correct approach to this situation, although it is a poor long-range strategy. There are cases which support the other methods, but the best approach is to be firm in all situations. Management may remove volume by allowing the discount, or it may retain volume by taking the loss on the account. When responding to such a challenge, have a variety of strategies.

When deciding which legal action to take, factors such as the amount owed, the likelihood of recovery, and the nature of the business must be considered. The credit department has become a key area in the decision-making process, and the establishment's ability to operate smoothly is heavily dependent on the effectiveness of the credit department. When a guest has fallen behind in payments, the credit department must be notified as soon as possible. If the account is determined to be uncollectible, it should be written off. If the account is determined to be collectible, the credit department must be informed of the status.

Another situation in which the credit department must be informed is when a guest takes an unearned discount. This is in the best interest of the establishment, and the credit department must be notified immediately. When a guest takes an unearned discount, it is possible that other discounts may be offered, and the credit department must be aware of this to prevent further damage to the establishment.

The credit department must also be notified when a guest has fallen behind in payments, either through a lack of payment or a failure to make the required payments. This is in the best interest of the establishment, and the credit department must be informed of the status of the account.

In summary, the credit department plays a critical role in the success of the establishment. The credit department must be notified of any changes in the status of an account, whether it be due to a lack of payment, a failure to make the required payments, or a guest taking an unearned discount. The credit department must be notified as soon as possible to prevent further damage to the establishment.

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Informing guests that they are borrowing money at very high rates of interest when they do not take the offered discount may encourage prompt payment. If you offer a 21% net 30 discount, payment within the first 10 days would save a 36 percent annual rate of interest.

Advantages to a cash discount are:
- Immediate cash on hand
- Lesser needs for borrowing from banks
- The ability to take cash discounts from purveyors

Disadvantages to offering a cash discount are:
- Guests take unearned discounts.
- Guests may feel they are being slighted because they do not have the ability to pay within the short period of time required.
- Some guests may feel they are being slighted because they do not have the ability to pay within the short period of time required.
- Collecting cash discounts gives no real economic value but is a source of encouragement to guests to pay when they should.

Cash discounts are allowable under the Robinson-Patman Act as long as they are allowed uniformly to all classes of all guests, not disallowing business versus social guests, as an example. A hospitality company may be in violation of this act by giving in to terms chiselers.

The credit manager must establish a strategy for collecting the debt. If a telephone campaign is launched, the person or persons doing the calling should be trained and polite and have a strong voice. In the case of large accounts, the manager should make the call. Callers should be firm and polite and have a strong voice. If a telephone campaign is launched, the person or persons doing the calling should be trained and polite and have a strong voice. In the case of large accounts, the manager should make the call. If a telephone campaign is launched, the person or persons doing the calling should be trained and polite and have a strong voice. In the case of large accounts, the manager should make the call.

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Collection Letters Are Effective

The most popular method of credit collection is the collection letter. Collection letters are effective but should be written in a clear, concise manner. The most popular method of credit collection is the collection letter. Collection letters are effective but should be written in a clear, concise manner.

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encounter. A second collection is generally done after the first one; this is to make sure the conditions are firm enough that the person will not try to negotiate and make sure the funds are actually received. If the company needs to change its mind, however, it is a very smart business to have the conditions of the second collection be the same as the first, but if the needs of the business change, then drastic measures are necessary. To make or stick to the decision to collect the funds even though it may mean losing the future sales volume of that client, it may be imperative to do so because of the potential loss of sales. Some people feel this may be a way to protect good customers if they discover a company's leniency.

When collection is so delinquent that management has run out of options, it may be time to turn to a collection agency. In many hotels, restaurants, or clubs, a specific 90 through 180-day cycle mandates turning receivables over to a collection agency. As a credit manager, it is important to establish the specific timing when receivables are turned over. This determination should analyze the probability of collecting the debt and the costs incurred in collection. It is important to remember that the collection agency is a company's legal agent and to remember that the collection agency is not a company's credit office. The people who work for a collection agency can be blunt and tough and can sometimes enrage the client. The hotel, restaurant, or club can blame the collection agency for its mistakes, but the credit office of your company did not commit the blunder. A good idea is to verify if agency personnel are bonded.

Because hotels, restaurants, and clubs have the right to charge interest does not mean they actually do. Many hesitate because of the potential loss of sales. Some people feel charging interest encourages late payments, but is all right as long as they pay. This puts the hospitality operator in the credit business, a position none wants to be in. When collection is so delinquent that management has run out of options, it may be time to turn to a collection agency. In many hotels, restaurants, or clubs, a specific 90 through 180-day cycle mandates turning receivables over to a collection agency. As a credit manager, it is important to establish the specific timing when receivables are turned over. This determination should analyze the probability of collecting the debt and the costs incurred in collection. It is important to remember that the collection agency is a company's legal agent and to remember that the collection agency is not a company's credit office. The people who work for a collection agency can be blunt and tough and can sometimes enrage the client. The hotel, restaurant, or club can blame the collection agency for its mistakes, but the credit office of your company did not commit the blunder. A good idea is to verify if agency personnel are bonded.

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interest costs by deferring payments. By paying on time, they will save themselves high interest costs. One of the most effective ways of encouraging the payment of debt is to allow partial or split payment. This should be allowed as an exception to the rule rather than as a set policy. It shows a company's willingness to work with a client who may be having a cash flow problem, fostering good will and encouraging future sales volume.

When accounts have been delinquent for some time, it is important to go through a management checklist to analyze and evaluate the type of delinquency. This list should reflect:

- What is the amount due?
- How long has it been overdue?
- What has been the client's pattern of payment?
- How long has this account been a client on the books?
- What have been the previous experiences with this client?

Computers Aid in Collection Management

Collection management has been brought into the modern era with the advent of computers. The speed and accuracy of the collections process is magnified with the reports available to management. Management must not forget, however, that the collections process in this industry is a humanistic one. It must not allow the mechanically-generated materials to take the place of human thought and reason. Credit managers must have the qualities to judge human nature and a vast knowledge of financial matters. They must be tough and thorough, and correct human nature where necessary. The problems that arise are complex and require a high level of expertise. The collection process, therefore, requires a great deal of human intervention, which cannot be automated.

In the past 25 years, a number of new laws regarding debt collection have come about. These laws have been established on the local, state, and federal levels and cover almost every area of credit collection. The majority of these laws have been adopted to make decisions regarding the extension of credit. The Federal Reserve System has prepared sample forms to use in making decisions regarding the extension of credit. These forms conform with the requirements of the law and help to ensure compliance with the laws. The Federal Reserve System has also published guidelines on the use of these forms.
The Federal Reserve will assist in securing them.

While it impractical to review the entire extent of the consumer credit legislation, it is important to review where the hospitality credit manager must go to find the credit legislation which pertains to the situation. Compliance with the Truth in Lending Act involves anyone who grants consumer credit. Only consumers are covered, which is to say the credit is used for personal, family, or household credit. All such credit transactions are covered up to $25,000, except real estate transactions, which are covered to any amount. The definition of a creditor, the one to whom the customer must make initial payments, is a person or business which extends credit more than 25 times a year which is payable by written agreement in more than four installments, or which is subject to a finance charge. The Truth in Lending Act takes precedence over state laws except where the Federal Reserve deems those statutes to be "substantially similar" to the act and to have adequate enforcement provisions backing them.

Credit managers should determine which laws apply in every area in which they do business. The substitution of state regulations applies only to disclosure (terms of credit disclosed before the credit is extended) and rescission (specifying the right to repeal a transaction by a specific date). The sections regarding garnishment, advertising, and loan-sharking apply to all instances.

Where federal and state laws differ, the credit manager must make two disclosures to satisfy the requirements of both, unless the state laws are preempted by the federal law. If management is unsure, the Federal Reserve Board can be contacted to determine if state laws are inconsistent with federal laws.

Debtors Also Have Rights

Inconsistent with federal laws, creditors cannot demand a payment from the applicant on the date of the application. The requirements of the Equal Credit Opportunity Act of 1977 take effect as soon as an application for credit is received. If neither the debtor, who successfully sues a creditor for failure to comply with a section of the Truth in Lending Act, or the creditor, who is required to make two disclosures to satisfy the requirements of both, unless the state laws are preempted by the federal law, fails to comply, the debtor may collect attorney's fees and costs of the suit, as well as real damage. The requirements of the Equal Credit Opportunity Act of 1977 are expressed as "substantially similar" to the act and to have adequate enforcement provisions backing them.

Those statutes to be "substantially similar" to the act and to have adequate enforcement provisions backing them are expressed as "substantially similar" to the act and to have adequate enforcement provisions backing them.

The debtor may collect attorney's fees and costs of the suit, as well as real damage.
For example, a debt collector may not:
- communicate to the consumer that the consumer owes any debt
- communicate by postage

The creditor may also ask about marital status in community property states, and in other states unless the application is for separate unsecured accounts. Within 30 days of receiving a completed application, the creditor is required to notify the applicant about what action has been taken on the application.

The Fair Credit Billing Act protects consumers against inaccurate or unfair practices of open-end credit. The act requires the creditor to inform debtors of their rights and the responsibilities of the creditor under the act. The principal responsibility of this act is to provide for prompt settlement of billing disputes.

The Fair Credit Reporting Act is an area many hospitality management establishments feel they never are responsible for learning. This is not necessarily true, however, if one of the following circumstances occurs:
- If a business sometimes or regularly tells other businesses what has been learned about a guest's creditworthiness.
- If a business shares data of this type with others in the business or location.

The Fair Credit Reporting Act is a very important part of consumer credit law. Its purpose is to protect consumers from penalties caused by incorrect information which may be contained in a company's credit files. A company should not include information in credit reports which are shown to be incorrect or cannot be verified.

The Fair Debt Collection Practices Act refers to one of the most pertinent areas which relates to the hospitality industry: the unfair, deceptive, and abusive practices in the collection of debts. It specifies prohibitions and limitations on what may be done by debt collectors and sets rules for collection practices in the collection industry. The Fair Credit Billing Act specifies that debt collectors may not:
- communicate to the consumer that the consumer owes any debt;
- communicate with anyone other than the debtor more than one time;
- communicate by postage or symbol on an envelope or
- communicate by postcard;

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The Fair Debt Collection Practices Act refers to one of the most pertinent areas which relates to the hospitality industry: the unfair, deceptive, and abusive practices in the collection of debt. It specifically creates prohibitions and limitations on what may be done by debt collectors by defining unfair collection practices, validating procedures regarding debts, specifying allowable actions regarding multiple debts, and stating actions taken by a debt collector who brings legal action and other actions taken by a debt collector who brings legal action and settling debtors' proceedings for the recovery of debts.

The Fair Credit Reporting Act is one of the most pertinent areas which relates to the hospitality industry: the unfair, deceptive, and abusive practices in the collection of debts. It specifies prohibitions and limitations on what may be done by debt collectors and sets rules for collection practices in the collection industry. The Fair Credit Billing Act specifies that debt collectors may not:
- communicate to the consumer that the consumer owes any debt;
- communicate with anyone other than the debtor more than one time;
- communicate by postage or symbol on an envelope or
- communicate by postcard;
The credit manager must be aware of the maze of procedures, court rulings, and laws which affect the hospitality industry. In addition, the credit manager must be aware of the rules which apply to the collection of commercial debt and the Uniform Commercial Code (UCC), which are extremely thorough and have been adopted by all states except Louisiana.

The Uniform Commercial Code (UCC) is very similar to the Truth in Lending Act and is controversial because it has not been adopted by all states. Another law which affects collection managers is the Uniform Consumer Credit Code (UCCC), which is extremely thorough and was adopted by all states except Louisiana.

The credit manager must be aware of the maze of procedures, controls, and laws which affect the hospitality industry. An intelligent familiarity with these strict regulations is necessary to be an informed credit manager. This law is to be taken lightly.

The Uniform Commercial Code (UCC) is extremely thorough and has been adopted by all states except Louisiana. With few exceptions, all credit transactions are covered in Article 9.

Commercial debt is covered by an entirely different set of laws, compiled in the Uniform Commercial Code (UCC). It is extremely thorough and has been adopted by all states except Louisiana. With few exceptions, all credit transactions are covered in Article 9.

Unfortunately, Article 9 was revised in 1972, 10 years after the original preparation of the Uniform Commercial Code (UCC). It was supposed to unify and simplify laws governing consumer credit. An intelligent familiarity with rulings from both versions of Article 9 is essential.

The credit manager must be aware of the maze of procedures, controls, and laws which affect the hospitality industry. An intelligent familiarity with these strict regulations is necessary to be an informed credit manager. This law is to be taken lightly.
Credit procedure starts with a well-thought-out strategy, followed by strict control systems intertwined with compliance with federal and state laws. Following all these procedures will enable a hospitality company to enjoy continuing profitability.

References

4. Ibid, p. 27.