WHAT ARE TERMS AND
WHY IS IT A GOOD THING?

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You've conceived or licensed an idea for a great product. You've designed, packaged, manufactured and imported that product. Or in the case of retailers, you've spent untold amounts of time, sweat and money choosing products. Now it's time to make back your investment by selling that product to your customers. You spend more money and go to trade shows, advertise in local publications, and purchase catalogs. You demonstrate the products to buyers who write an order! You ask for payment and the buyer says she'll pay you… in 30 days. She wants credit. Hold on a minute. You had to pay for everything as you went so why in the world shouldn't she?

Selling on credit is a fait accompli so get used to it. Normally, retailers are granted 30, 60 or 90 days (Net 30, Net 60 and Net 90, respectively) from the shipping date in order to pay for their order. Some wholesalers even extend something called "dating." This is a longer net period of time that can last up to a year and is usually given by well-capitalized companies with solid cash flow.

There are many positive aspects to extending net terms. First of all, by letting a customer have a longer period of time to pay for your products they will, in all likelihood, place larger orders. (As a wholesaler or manufacturer you are giving the retailer time to pay you out of their sales, not their cash on hand.) Additionally, by extending net terms rather than requesting pre-payment terms on credit card or waiting for a check, you can potentially increase the number of reorders you may get from your customers.

Depending on your payment policies, extending credit also makes you more profitable. This is because most pre-payment terms are conducted with credit cards. And since the cost of credit card transactions can run upwards of 5% and $.50 per transaction you are, in essence, giving discounts. Therefore, if you are already giving some type of discount (e.g. free freight) this can add up.

Accepting checks is another way of getting pre-payment but waiting for the check to clear will slows things down and without waiting for the funds to clear you're still rolling the dice. In this case, the best thing for your company would be to have the customer send a certified check. The down side is that most customers will balk at this because it makes them have to work harder to purchase your product.

If you do decide that the increased costs are worth the decreased risks and agree to pre-payment terms then avoid working on COD terms. Oftentimes customers refuse COD shipments when they arrive. It may be because the owner forgot to leave a check, it may be because the buyer forgot to tell the staff, or it may simply be that they changed their minds. Whatever the reason, the result is that you have to absorb the shipping fees and get back product that in most cases must be repacked to reship.

Perhaps the best reason to sell on credit is that *you will get more customers*. The simple truth is that many customers will not buy from you, or continue to buy from you, if they can't get terms. So if your goal is to get maximum distribution you need to extend terms.

WHAT INFORMATION DO YOU NEED?

The average percentage of bad debt for toy and educational manufacturers and dealers selling to the specialty market is approximately 1- 3 % per year. This may seem low but even for a small company doing $250,000 in sales it means they will lose between $2,500 and $7,500.

This number will most likely increase due to the startling rise in bankruptcies. According to *Credit and Collections World*, Chapter 7 business liquidations in 2007 have risen 57.6% over 2006. So if you're going to extend terms there are steps that must to be taken to minimize your risks. And you need to take these seriously as you are essentially giving loans to strangers.

Good credit practice begins at the time of the sale. First and foremost, you need to clearly state your company's expectations up front ("terms granted with approval process") to both salespeople and customers. Your company's terms should be printed on all sales order forms and invoices. You need to stand firm on these and not be concerned about possibly losing orders. Because unless you get paid it is not a sale.

In addition to stating your terms on your sales orders you need to gather credit information from customers. This should be done with pre-payment customers too, as they may one day want to change their terms with you.

At the very least you should get credit sheets. (Retailers usually have one.) These are pre-printed forms that contain the potential debtor's legal entity name, address and telephone numbers. It also lists the company's resale #, federal id#, bank account information and trade references.

Unfortunately, for many manufacturers, dealers and wholesalers just *having* the above information is enough for them to grant credit. They don't actually do any credit checking. Perhaps this is because they don't know how, or they don't feel they have the time. Or, it could simply be because they've never had a problem with a customer not paying them. This is, of course, the exception not the rule. Eventually, they will get burned. It's not that most customers don't pay their bills on time, but the reality is that many do not. It is against those companies that you must protect yourself.

HOW TO CHECK CREDIT?

While checking a customer's credit information is not difficult, it can be tedious and time-consuming. However, because you are extending a loan a little bit of research is the least you can do to protect yourself.

According to the Fair Credit Reporting Act ("FCRA") businesses have the legal right to check the credit of other businesses that have applied to them for terms. If, however, an ***individual*** (this includes DBAs with social security numbers) applies to you for credit then you are constrained in how you can check their credit. If that is the case then you should always get a credit card, pre-payment or a personal guarantee.

The simplest, least expensive and most objective way to check credit is by asking the references listed on the customer's credit sheet to tell you their experience with your potential customer. While it is almost guaranteed that these references will relate positive experiences, it is still something you need to check. Most companies have a form that they fax to the references asking specific questions. If you opt to do this the very least that you need to ask is:

- # of years doing business
- Highest credit given
- Date of last invoice
- Terms given
- Does the customer pay within terms
- Comments

In addition to getting credit references it is highly recommended that you check with the potential debtor's bank. Credit sheets should list the retailer's bank name, their account number and fax. You can contact the bank's commercial officer and ask them to provide you with the following information:

- How long has the account been open
- Is the account in good standing
- Average daily balance
- Number of NSF checks
- Open credit lines and amount of credit drawn on them

A good gource of information is The Better Business Bureau. Their entire North American database is online and free. BBB reports not only show you how people have responded to a company but how that company has treated those individuals in regards to clearing up any problems. Getting information such as DBAs, additional addresses and names of owners and/or company principals can be helpful should you ever need to submit the account for collections.

For those of us who desire to get more information there are credit interchanges. These companies operate by periodically gathering the A/R of their respective members then use an algorithm to create ratings based on combined average agings. While this means of information mining is somewhat effective it is not specific and does not allow you to see the source of the information. You are relying on others to rate a potential debtor for you.

Then of course there are sources like Dunn & Bradstreet and Experion. These companies have a great deal of information to provide but since you don't know the source of the information it may not be pertinent to your industry. Additionally, the cost of getting credit reports from these sources is very high and when it comes to checking the credit-worthiness of specialty retailers, not worth the investment. Unfortunately, these services offer very little reliable information on smaller retailers.

The last, and best, kind of credit agency is the credit consortium. These member-based organizations are industry specific and provide a means for members to exchange references and credit alerts online. They do not rate potential debtors but, rather, give you the raw data so that you can draw your own conclusions. In addition to getting real-time references on customers in your market directly from your peers, you can also get credit alerts and qualified sales leads.

GRANTING CREDIT

After you've gone through all or some of the previous steps to get information about an account you should know whether or not you feel comfortable lending them your money. I say "comfortable" because there is always going to be an element of not knowing. Even companies with high credit ratings declare bankruptcy. It's very personal and every company has its level of risk tolerance. Since it's your money you need to feel comfortable about lending it to a complete stranger; which let me say it again, is what you're doing.

If you feel good about it then start off with a small order and see how it goes. If the account pays within terms you can increase their credit limit and give them longer terms on their next order. Of course, if you're not comfortable extending credit then tell the account you need to ship the first order on a pre-pay basis. If it's a specialty account (as opposed to a mass merchant) and they want the product enough this won't be a problem for them.

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