collective wisdom®

SZABO ASSOCIATES, INC. VOLUME 23, ISSUE 4, DECEMBER 31, 2008

Dear Friends:

As we move forward into 2009, we all are probably expressing the same sentiment—"What a year it has been!" The economic downturn, which began in the housing and financial sectors, has spread to the automotive and retail industries and is now rippling through the rest of the economy. The lives and fortunes of Americans throughout the country, many of whom have never witnessed a crisis of this magnitude in their lifetimes, are being seriously affected.

As we take lessons from the past, let us step back and remind ourselves that the best approach to turning our economy around is to maintain an objective, long-term view to overcome our short-term challenges. Better times are ahead!

All of us here at Szabo wish you a very Happy New Year!

Robin Szabo, President
Szabo Associates, Inc.

5 Mistakes You Cannot Afford to Make in a Bad Economy

At the time of this writing, bleak reports offered more evidence that the U.S. is indeed experiencing a recession, which some economists believe may prove to be the worst in 25 years. While the financial services, automobile, and construction industries bore the initial body blows this year, last quarter statistics indicate that the downturn is having a severe impact on other sectors as well, here and abroad. Declining consumer spending and business investment have led to decreased manufacturing production and increased job losses. The U.S. unemployment rate reached a 14-year high in October, pushing total job losses for the first 10 months of the year to 1.2 million and reflecting a broad-based pullback across manufacturing, construction, and most service industries.

Bankruptcy statistics are equally grim. According to data compiled by Automated Access to Court Electronic Records (AACER), filings by U.S. businesses rose 67% in September from a year earlier. Consumer filings increased 40% in October from the same period last year, according to the American Bankruptcy Institute. At the current rate, total filings for the year will be 30% higher than in 2007 and 80% higher than in 2006.

An additional indicator that the downturn may be serious and that recovery may take some time is the yield curve, which measures the gap between yields on 2- and 10-year government securities. The gap tends to widen in a weak economy as central banks cut rates to spur growth, with short-dated yields falling more than longer-dated yields. For the steep curve to help the economy, banks have to lend the money they borrow, which they have been reluctant to do. As companies find it harder to get financing, business spending will likely be cut, layoffs will continue to mount, and the number of consumer and business bankruptcies will continue to rise.

Media properties are now faced with increased competition for customers, many of whom are cutting their advertising budgets as they struggle to get the credit they need to continue their operations. Although it is tempting, in these circumstances, to shortcut due diligence and ignore terms and conditions, there are five mistakes that you

—continued on page 2

5 Mistakes —

—continued from page 1

simply cannot afford to make:

1. Failure to re-examine policies and procedures.
In good times, it is wise to periodically review your company's policies and procedures. In bad times, it is critical, for two reasons. The first is that the objectives that provide the framework for detailed policies and procedures may need to be "re-thought" in order to successfully accommodate changes in your organization and changes in the marketplace. Overall policy objectives should address the balancing act between credit extension and collection requirements. While one organization may choose to balance a somewhat liberal credit extension policy with conservative collection operations, another may choose to have a tighter credit extension policy, lessening the need for strict collection procedures. Some organizations try to strike an equal balance between the two. Each of these choices is viable, assuming it is deemed the best choice for your organization to effectively optimize sales, minimize past-due receivables, minimize bad debt losses, and contain costs while maintaining effectiveness and efficiency.

The second reason is that policy review provides the opportunity to ensure that credit managers and sales managers are "on the same page." A bad economy can magnify some of the age-old conflicts between sales and credit. Including both departments in the review process allows all involved to discuss perceived shortcomings of the existing policy and to "sign off" on any changes. Without policy review in bad economic times, organizations can easily "disconnect," using practices that seem most expedient from an individual or departmental standpoint, but which run counter to written policy and procedures.

2. Failure to collect past-due money on current customers.
Pressure to bring in revenue in a downturn can motivate company management to let sales drive business, without due consideration to credit and collections. We know that many media properties are continuing to do business with delinquent customers on a cash-in-advance basis while letting past-due amounts "ride" with no charge-backs to sales on uncollected amounts.

This unfortunate practice is akin to letting money fly in through the front door while allowing it to fly out through the rear door. It is understandable that management wants to do all it can to bring in revenue each month; however, allowing customers to ignore terms of payment sends the message that you may relax on enforcement of those terms when times get better. Additionally, this practice is a game of diminishing returns since the cost of maintaining past-due amounts continually diminishes their value, and the price of replacing the value of amounts that are written off is four to one.

A better idea is to negotiate with the customer to establish a reasonable payment schedule for the overdue amount while collecting payment-in-advance for new advertising. By using a "principled" or "win-win" approach to negotiating as opposed to a "positional" or "win-lose" approach, you should be able to reach a favorable arrangement while maintaining a good relationship with the customer. What differentiates principled negotiation from positional negotiation more than anything else is its focus on determining, understanding, and addressing the underlying interests or concerns of the other party. In the current economic environment, perhaps the customer has been unable to get adequate financing to maintain operations and inventory, or the decrease in consumer spending has caused a dramatic drop in sales. By asking the debtor questions and expressing sincere concern, you will likely learn whether the problem is relatively short-term or long-term, and what you can reasonably ask the customer to do under the circumstances.

Because it is a collaborative process, the debtor/customer should come away from the table feeling respect for your firmness and flexibility, and feeling respected because of your fairness and interest in his situation. Aside from the obvious benefit of collecting money that is past-due, this approach carries the additional benefit of maintaining a business relationship that will be free of misunderstanding and false assumptions in future dealings in better economic times. (For more detailed information on negotiation strategy and techniques, see *Collective Wisdom*, December 2005.)

3. Failure to use the "C's" to determine creditworthiness.
Given the events of the past year, we cannot help but wonder if the meaning and impor-

tance of the five "C's," long an integral part of every credit grantor's lexicon, have become lost in certain industries and agencies. Had character, capacity, capital, conditions, and collateral driven the individual and collective behavior of participants in this year's financial meltdown, perhaps we would not be suffering such heavy consequences.

In practice among credit grantors, the usual order of importance of these factors is collateral (assets to secure the debt), capacity (sufficient cash flow to service the debt), capital (ability to raise additional money through asset financing or selling), conditions (of the customer and the overall economy), and character. Of course, in the media industry, collateral does not apply. The remaining four do apply, however, and should always be given serious consideration.

In our experience, for the media industry, character should assume the number one position as the most important consideration in credit extension (see *Collective Wisdom*, June 1987). Character, in the credit granting context, is simply the probability that a customer will try to honor his obligations, which can best be determined by the prospect's payment history. If a customer experiencing cash flow problems due to a troubled economy has integrity, chances are that he will make every effort to cooperate with respectful efforts to collect on his past-due account.

4. Failure to monitor companies and industries for signs of distress.

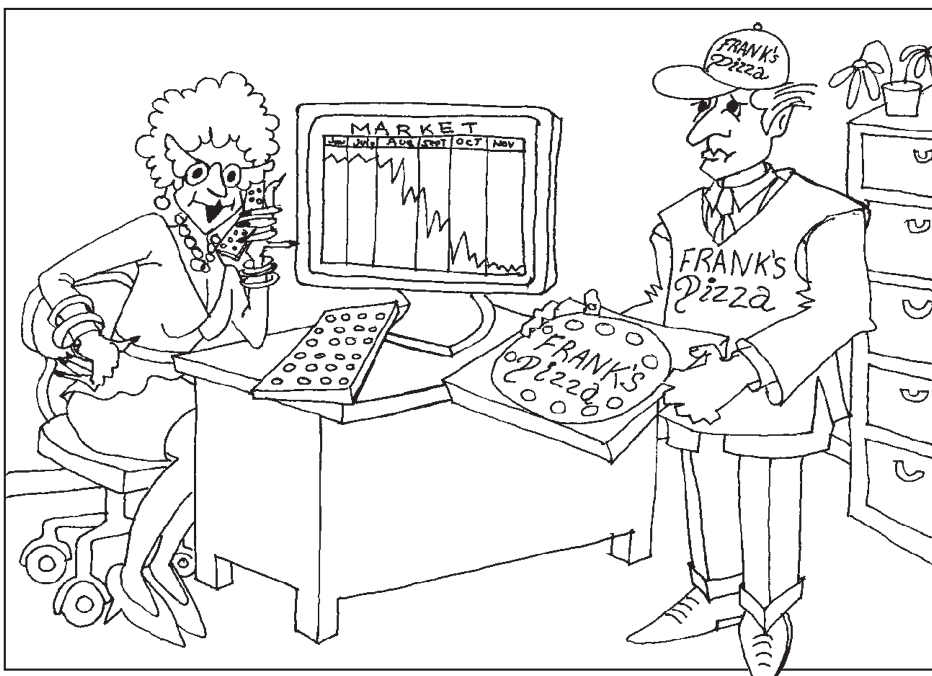
By the last quarter of the year, economic woes had spread across virtually all sectors of the economy and to all areas of the country. The U.S. Labor Department reported job losses in most sectors, with gains in only health care and government. Personal consumption spending, which accounts for 70% of gross domestic product, fell at a 3.1% annual rate in the third quarter of 2008, the worst decline since 1980. American consumers, constrained by debt and tight credit, are now no longer able to buy the goods and services they became accustomed to buying in the past.

At this time, credit managers should closely monitor <u>all</u> industries through financial magazines, newspapers, and financial websites. Additionally, individual companies should be carefully watched for signs of distress, and frequent meetings among staff members should be held to share information. Any change in payment habits or advertising frequency can be an early sign that a company is in trouble. We all have witnessed businesses that have suddenly closed their doors, leaving customers and creditors with little recourse for unmet contractual obligations.

5. Failure to acknowledge the "perishability" of past-due accounts.

The statistics on personal and business bankruptcy filings in the past year have been sobering to credit managers, who have long recognized the correlation between the number of bankruptcies and the degree of difficulty in recovery or liquidation of bad debt.

When your customers are struggling to keep their businesses going, it may seem unwise or perhaps callous to insist on strict adherence to your terms of payment. On the other hand, customers expect you to honor your side of the agreement, and it is unfair for them to expect your company to lose money by failing to pay on time. Receivables allowed to age from date of invoice to 90 days have about a 70% chance of being



"About that 'Smart Sales Strategies in Tough Times' seminar you were considering, Boss . . . I think it may be overdue."

—continued on page 4

5 Mistakes —

—continued from page 3

collected. By 180 days, the probability drops to about 50%. By one year, the chance of collecting is less than 23%.

If your terms and conditions call for payment within 30 days, the collection process should start on day 45 with follow-up at least once a week. If your company chooses to continue doing business on a cash-in-advance basis with customers whose accounts are delinquent, a payment schedule for the overdue money should be negotiated and firmly enforced.

A credit manager's prime directive is to maximize cash flow for the company, a responsibility made more difficult by a tough economic environment. As the number of perishable accounts increases, it becomes increasingly important for credit and collection staff to focus collection efforts on significant amounts that are 90 days or less past-due than to spend time and resources to collect relatively insignificant amounts that have aged beyond 90 days.

The services of a collection agency should be enlisted when the account is 90 to 120 days past-due, depending on its perishability. Additionally, a third-party collector should be enlisted immediately if the debtor has "skipped" (moved without informing creditors or leaving a forwarding address) or it is suspected that the debtor intends to do so; the debtor has broken promises (failed at least twice to make promised payments); the debtor has taken personal offense at being asked for money owed; or, there are unfounded disputes, and the debtor refuses to accept evidence that this is the case.

As we usher in the new year and a new administration, American businesses and consumers are bracing for months more of tight credit, rising unemployment, and concern that conditions could get even worse before they get better. Those of us who recall the serious recession of the early 80's know, of course, that conditions will improve and lessons will be learned, albeit the hard way. We also know that businesses that fare the best during bad economic times are those that stay informed about changing market conditions and continue to uphold the fundamental principles of credit and collections. ♦

Collective Wisdom® is a publication of
Media Collection Professionals,
3355 Lenox Rd., Suite 945, Atlanta, Georgia 30326
Tel: 404/266-2464, Fax: 404/266-2165
Web site: www.szabo.com
e-mail: info@szabo.com

©Szabo Associates, Inc. 2008. All rights reserved. Materials may not be reproduced or transmitted without written permission.

PRESORTED STANDARD
U.S. Postage
PAID
Atlanta, GA
Permit No. 747