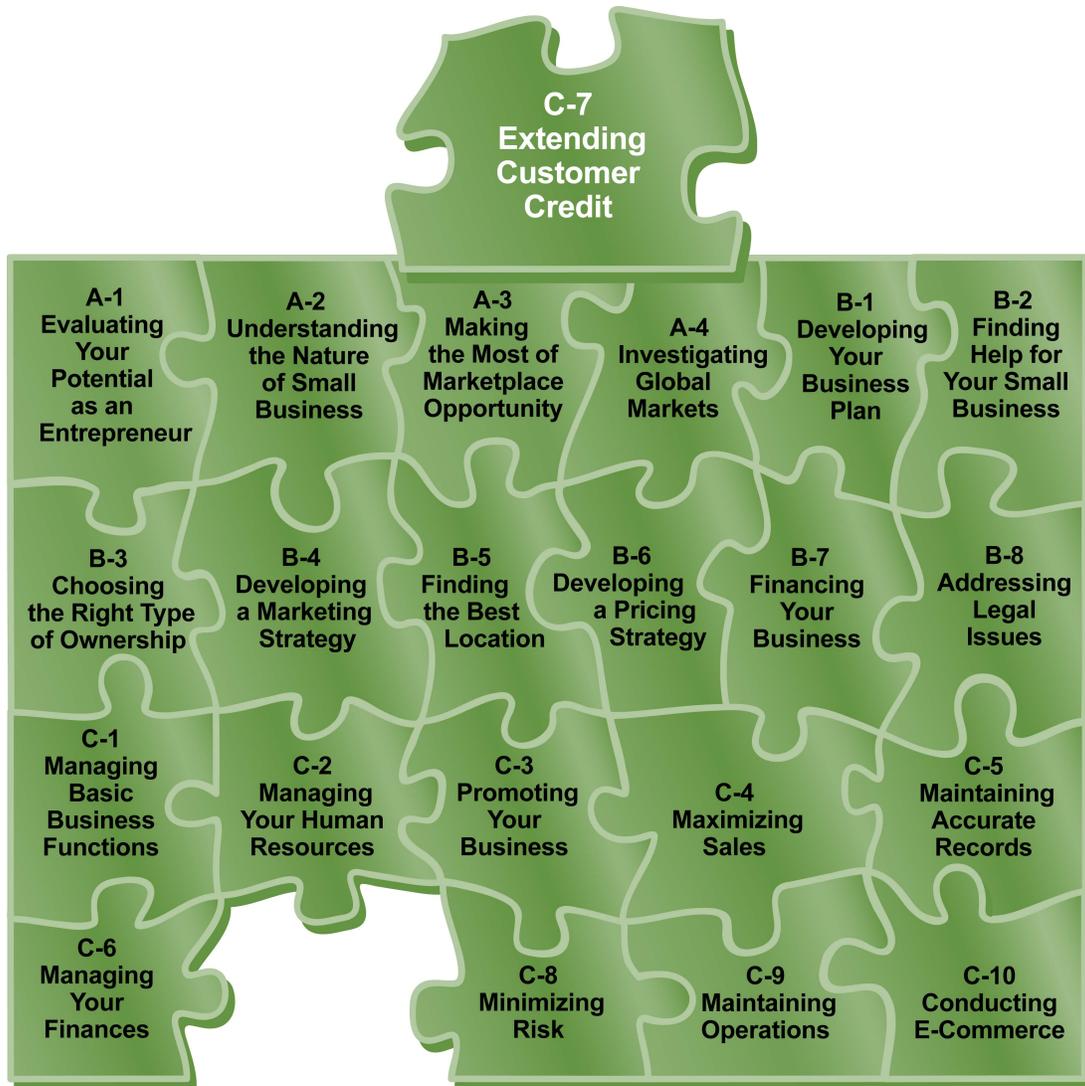


# PACE

## Fourth Edition

## Program for Acquiring Competence in Entrepreneurship

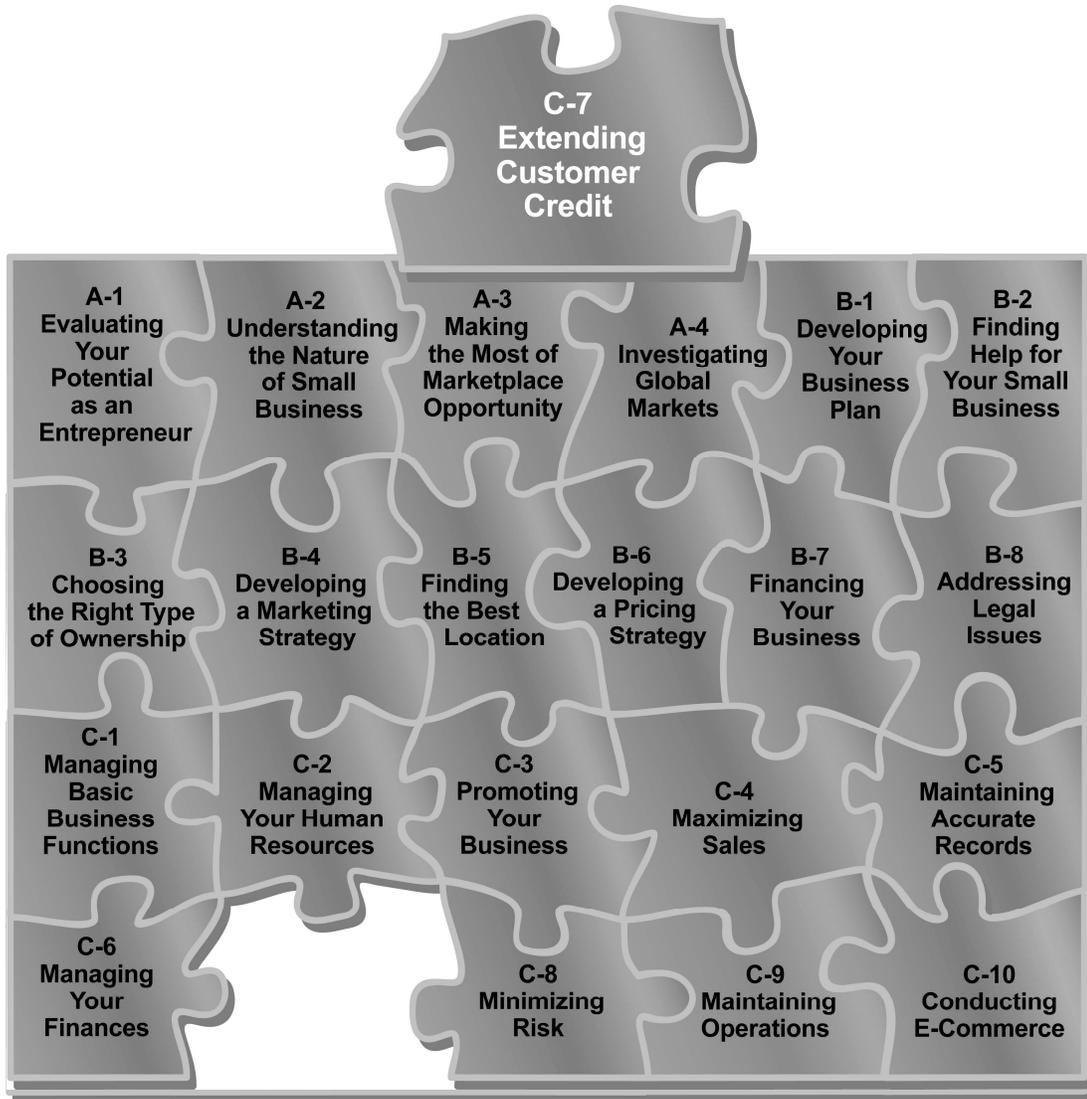




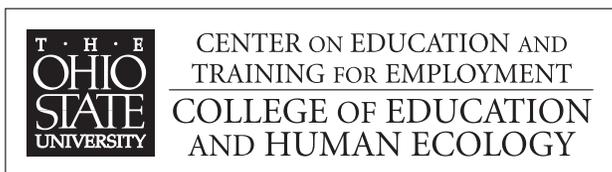
# PACE

## Fourth Edition

## Program for Acquiring Competence in Entrepreneurship



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This version of PACE was supported in part by a grant from OSU Extension.

## Foreword

I am pleased to introduce you to the Fourth Edition of the Program for Acquiring Competence in Entrepreneurship (PACE). PACE represents our continuing effort to respond to the needs of the education and business communities. At no other time in history has understanding entrepreneurship been as important. For one thing, promoting entrepreneurship carries the societal imperative as small businesses as a whole contribute much to the growth and renewal of regional and national economies.

When first published in the late 1980s, PACE properly emphasized that entrepreneurship was based as much on sound planning as having products and services that were responsive to the marketplace. Through its various revisions, PACE continued to focus on the general importance of planning and managing the startup of a small business.

The current PACE edition represents a necessary break from past versions in both its format and some content. For one thing, the text format has been substantially changed from paragraphs to a series of related sections with subheadings. This change allows readers to have greater accessibility to the information, whether it is delivered via a printed booklet or a technology-based approach. And the format allows the instructor/facilitator to have greater flexibility in selecting content to accommodate the needs of various audiences and settings.

In terms of the content, PACE continues to emphasize the importance of planning and managing of a small business. But it now includes a renewed emphasis on meeting customer expectations. Any business cannot exist without a comprehensive understanding of who receives its products or services. In this sense, PACE introduces the topic of conducting e-commerce. Until recently, the entrepreneurial horizon may have been limited to serving local customers only. The advent of the Internet offers the promise of serving many more customers, but not without the accompanying challenges.

This edition was supported in part by a grant from OSU Extension and in partnership with OSU South Centers – Piketon. We hope that PACE will provide you with the understandings necessary to help you to achieve your entrepreneurship goals.

Ronald L. Jacobs  
Director  
Center on Education and Training for Employment



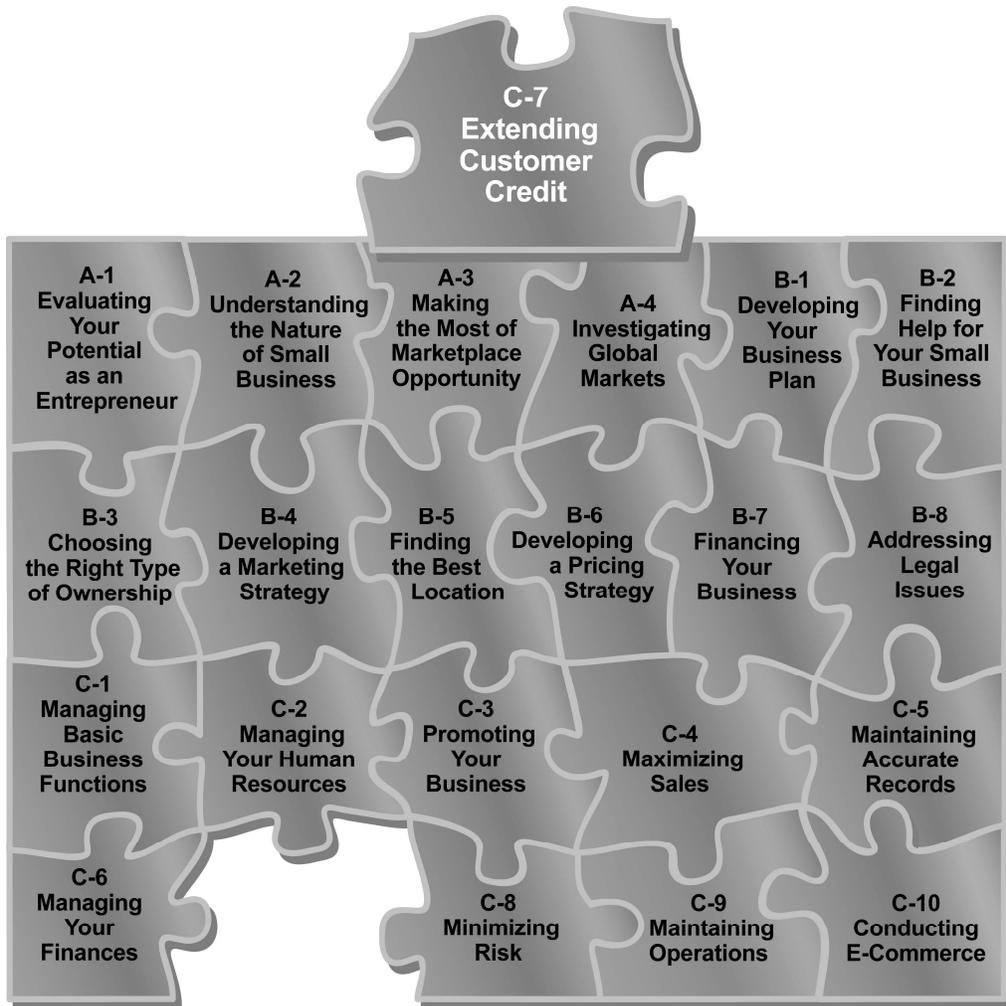
# Overview

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## Introduction

Offering credit to customers encourages them to buy more and come back often. It develops a strong customer base, ultimately leading to increased sales and fostering loyalty among existing customers.

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## Overview, Continued

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**Rationale** An appealing credit plan attracts new customers and encourages returning customers to buy more expensive items on a regular basis.

---

**Objectives** By the conclusion of this module, you will be able to:

- Describe the basic principles of extending credit to customers including:
  - phases of the credit process
  - casual vs. strict credit policy
  - types of credit plans
  - record keeping.
- Compare and contrast the advantages of offering credit to your customers with its disadvantages.
- Explain how to evaluate credit applications including:
  - the Three C's
  - required applicant data and sources for obtaining the data needed.
- Compare and contrast secured with unsecured credit devices.
- Describe how to set credit limits.
- Explain the collection function of credit programs including:
  - average collection period
  - accounts receivable aging system
  - collection procedures and guidelines
  - legal vs. illegal collection practices.
- Describe an effective credit promotions program.

---

**Relevant NCSEE standards** This module aligns with the following National Contents Standards for Entrepreneurship Education (NCSEE):

- I.10 Establish credit policies.
- I.11 Develop billing and collection policies.

More information on the NCSEE is available at: [http://www.entre-ed.org/Standards\\_Toolkit](http://www.entre-ed.org/Standards_Toolkit).

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*Continued on next page*

## Overview, Continued

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### Topics

The topics in this module are:

Topic	See Page
Credit Basics	4
Why Offer Credit?	9
Evaluating Credit Applications	10
Secured vs. Unsecured Recovery Devices	13
Setting Credit Limits	15
Collections	17
Credit Promotions	23

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### Exhibits

There are no exhibits in this module.

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### Before you begin

After reviewing the above objectives for this module, determine whether you can already meet those objectives and consult your instructor if you can.

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# Credit Basics

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**Introduction** A well-designed credit policy can be very beneficial to your company. Credit programs have the potential to provide your small business with increased sales and a loyal customer base.

---

**Challenges** Risk is an intrinsic part of any credit plan. When you decide on the rules for offering credit to your customers, you have some important decisions to make in order to reduce the risk and increase the likelihood of receiving timely payment.

---

**Two phases** The two phases of customer credit are granting credit and collections. The table below compares and contrasts the phases of casual and formal credit policies.

Phase	Casual Credit Program	Formal Credit Program
Granting credit	No thorough credit check.	Strict credit history assessment.
Collections	<ul style="list-style-type: none"> <li>• Allows customer to pay slowly</li> <li>• May result in slow collections</li> <li>• Greater exposure to loss</li> </ul>	<ul style="list-style-type: none"> <li>• Demands payments on schedule</li> <li>• Slow sales for businesses with less cash flow</li> <li>• Less exposure to loss</li> </ul>

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**Casual vs. strict** The credit policy that you ultimately choose will depend on your own situation. Consider the conditions below when you make the decision about offering credit.

If you are involved with...	Then choose...
large sums of money and a small profit margin	strict credit policies.  <u>Example</u> : travel agency
high profit margin and stable economy	more casual credit policies.

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*Continued on next page*

## Credit Basics, Continued

### Additional factors

The strict or casual nature of your credit policy depends on factors such as:

- the credit programs offered by your competitors
- the extent to which you depend on credit for making sales
- your ability to handle customers who can't make timely payments
- the resources you have available to collect debts.

### Credit plans

Small businesses typically offer one of several types of credit plans. The table below describes the most common ones.

Type	Description
<b>Direct Credit Accounts</b>	
Revolving credit accounts	<ul style="list-style-type: none"> <li>• Offers a maximum amount of credit for the customer to use anytime.</li> <li>• Generally no set time for paying in full.</li> <li>• Outstanding balance may be subject to interest charges.</li> </ul>
Installment credit accounts	<ul style="list-style-type: none"> <li>• One-time charge with the balance paid in equal installments over a set period of time.</li> <li>• Usually the seller has a claim on the title of the product purchased until the account is paid in full.</li> </ul> <p style="text-align: center;"><u>Example:</u> for buying expensive items such as cars and furniture.</p>
Regular credit accounts	<ul style="list-style-type: none"> <li>• Allows the customer to buy the product any time during a 30-day period.</li> <li>• At the end of 30 days, the balance is payable in full.</li> <li>• Also referred to as an open account.</li> </ul>
Budget credit accounts	<ul style="list-style-type: none"> <li>• Often set with payment due every 30 days.</li> <li>• If payment is made as scheduled, no interest is charged.</li> </ul> <p style="text-align: center;"><u>Example:</u> 90 days same as cash</p>
<b>Bank and Travel and Entertainment Cards</b>	
Bank credit cards	<ul style="list-style-type: none"> <li>• Banks offer these credit cards for use at any participating business.</li> <li>• Banks charge the business a small fee for providing this service.</li> </ul> <p style="text-align: center;"><u>Examples:</u> MasterCard and VISA</p>
Travel and entertainment cards	<ul style="list-style-type: none"> <li>• Similar to bank credit cards except that the balance is due in full at the end of each month.</li> </ul> <p style="text-align: center;"><u>Examples:</u> American Express and Diners Club</p>

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## Credit Basics, Continued

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### Open and closed-end credit

There are basically two ways to buy goods and services on credit – open-end credit and closed-end credit.

**Open-end credit** – With open-end credit, the customer opens an account and buys things from time to time on credit. It has the following characteristics:

- The buyer obtains open-end credit by opening a charge account and then using a credit card to make purchases
- The consumer may continue buying on credit and adding to the amount owed for as long as he or she keeps making monthly payments
- Interest is computed on the amount that is owed each month.

**Closed-end credit** – With closed-end credit, the customer buys a single item and agrees to pay for it later on an installment basis (usually monthly payments).

Examples: This type of credit is often used for cars and furniture. Closed-end credit is involved when the individual obtains a loan and agrees to repay it in installments at a later time.

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## Credit Basics, Continued

### Open and closed-end advertising

**Advertising** – The table below presents the information that the creditor is required to disclose for open and closed-end advertising.

Open-End Credit	Closed-End Credit
<ul style="list-style-type: none"> <li>• Time period in which the customer must pay in order to avoid finance charges</li> <li>• Method of computing the balance on which the finance charge is based</li> <li>• Method of computing the amount of the finance charge, including any minimum charge</li> <li>• Annual percentage rate</li> </ul> <p><u>Example:</u> A proper advertising disclosure for open-end credit might read as follows:</p> <p><i>No finance charge is incurred if payment is received within 30 days from the closing date shown on your monthly billing statement. If any purchase remains unpaid for 30 days from the closing date shown on your monthly billing statement, a finance charge at the periodic rate of 1½% per month of the total past due balance is imposed.</i></p> <p><i>The annual percentage rate is 18%, and the minimum monthly payment is \$10.00.</i></p>	<ul style="list-style-type: none"> <li>• Cash price</li> <li>• Amount of down payment required or the fact that no down payment is required</li> <li>• Number of payments, amount of each payment, and due dates or period of time between payments</li> <li>• Annual percentage rate in exact terms</li> <li>• Deferred payment price (total cost)</li> </ul> <p><u>Example:</u> A proper advertising disclosure for closed-end credit might read as follows:</p> <p><i>The cash price is \$100.00 and no down payment is required. The annual percentage rate will be 35% with 12 monthly installments of \$10.00 each. The deferred payment price will be \$120.00.</i></p>

*Continued on next page*

## Credit Basics, Continued

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**Record keeping** Accurate records are essential for reviewing customer accounts and setting credit limits.

**Demographics** – Collect demographics when maintaining credit records. You can use these statistics not only for marketing but also to formulate the most appropriate credit policy and procedures for your market.

**Account ledger** – Keep detailed records of credit purchases to provide accurate information concerning the amount of money owed to you. Record the following data in your account ledger:

- customer name and address
- maximum amount of credit allowed
- date each item was purchased on credit
- description of item purchased on credit
- amount of each credit purchase
- amount of each payment received
- outstanding balance.

**Collections** – Include the following collections data in your records:

- monthly reporting on accounts receivable to reflect
    - accounts 30 days past due
    - dollar amount unpaid
    - percentage of total credit volume of overdue credit
  - average collection period
  - accounts receivable aging system.
-

## Why Offer Credit?

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### Reasons to offer credit

Before you decide whether to offer credit, review the following reasons for doing so and determine whether a credit program will benefit your business.

#### *Charge accounts create customer loyalty*

- If customers can make a purchase on credit, they appreciate the chance to charge the purchase instead of handing over the cash they have on hand
- These consumers return as loyal customers because you've expressed confidence in them by granting them credit.

#### *Customers who have a charge account are less price-conscious*

- Customers are more likely to make purchases with credit than with cash
- Credit attracts customers who will pay more for higher quality. You may attract consumers interested in quality, service, and style rather than the ones only looking for low prices.

#### *Credit helps smooth out costly peaks and valleys in business*

- Customers with credit tend to buy items whenever the goods and services are needed rather than wait for a sale.
- 

### Advantages vs. disadvantages

The decision to offer credit depends on your specific goals and business conditions. Consider the points in the table below that compares and contrasts the advantages and disadvantages of offering credit.

Type	Advantage	Disadvantage
Bank credit cards Travel and entertainment cards	<ul style="list-style-type: none"> <li>• Provides convenience of use to customers</li> <li>• Encourages making purchases</li> <li>• Your individual business isn't responsible for collecting debt</li> <li>• Individual company doesn't suffer a loss if the customer doesn't pay as scheduled</li> </ul>	<ul style="list-style-type: none"> <li>• Bank offering the card takes a percentage of each sale made through transaction fee</li> <li>• Cost of offering credit increases the cost of goods and services for sale which is passed on to the customer</li> </ul>
Direct credit accounts	<ul style="list-style-type: none"> <li>• Increases consumer purchases</li> <li>• Promotes customer loyalty</li> <li>• Enhances competitiveness</li> <li>• Eliminates the transaction fee</li> </ul>	<ul style="list-style-type: none"> <li>• Increases the risk to your company of uncollected debt</li> <li>• Need personnel for accounts receivable</li> </ul>

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# Evaluating Credit Applications

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**Introduction** Although your criteria for approving credit may differ from those of another small business, some general rules are commonly accepted for determining credit-worthiness. You can avoid credit problems by evaluating credit applicants.

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**Rationale** This evaluation will identify the people who are willing and able to pay and protects you from the ones who have no intention of paying or are historically slow in making payments.

---

**Three C's of assessing risk** The basic rules for evaluating the risk in credit applicants are referred to as the Three C's of credit.

**C****haracter** – This element is the most important of the Three C's. It's based on the person's sense of responsibility in meeting financial obligations.

Examples: A person who has always managed to pay bills on time rates high by this standard. A person who has enough money to pay bills but doesn't feel obligated to pay promptly is not considered a good character risk.

**C****apacity** – This term refers to the person's ability to earn money. It reflects the job skills to remain steadily employed at a level high enough to meet the person's financial obligations.

Examples: An employee in an industry with seasonal layoffs and a person with more financial responsibilities than his or her earnings can cover both rate low by this standard. On the other hand, somebody in a very secure job with a positive work history is a good capacity risk.

**C****apital** – This factor defines the physical and financial assets of the credit applicant. It refers to what the person already owns. To most small business owners, this element is the least important when evaluating risk.

Example: If an individual has property, savings, or other investments that he or she could sell to pay off a debt, he or she is considered a good risk in the area of capital.

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## Evaluating Credit Applications, Continued

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**Applicant data** When considering whether to accept a credit applicant, base your decision on:

- length of time at current address (also previous address if the current address is recent)
  - employment history
  - current job situation (salary, length of employment)
  - monthly financial obligations
  - number of dependents (include alimony payments)
  - bank balances
  - personal assets
  - outstanding credit with other businesses
  - amount of credit requested.
- 

**Sources of information**

When checking the information on credit applications, go to these sources:

**Employer** – Start with the employer. Ask whether the applicant is indeed employed and determine whether income and time on the job have been reported accurately.

**Bank references** – Next, check the applicant’s bank references. This step will protect you from fraud and give you an indication of the applicant’s ability to pay. Bank personnel will:

- confirm that an account exists
- give you the person’s average bank balance
- tell you whether the person has met the bank’s obligations.

**Credit bureaus** – Credit bureaus are an important source of information on credit applicants, especially persons living in the local market area. You don’t have to be a member to access these services, but fees are lower if your company is a bureau member. Credit bureau services include:

- checking on people new to the area
  - providing data on changes in credit ratings
  - tracing customers who leave town
  - collection of accounts on poor risks.
- 

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## Evaluating Credit Applications, Continued

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### Point system

Some banks, credit organizations, and large companies use a point system to determine credit-worthiness. They assign a number of points for certain positive risk factors and then base their decision on the sum of the points. The positive risk factors considered include:

- owning a home in the community
  - having a bank account
  - length of time on the job
  - income level.
- 

### Special cases

There are some cases that deserve special consideration when evaluating credit risk. Consider these points when deciding whether to grant individuals credit in special circumstances:

- You may choose to grant credit only if the individual already has a major credit card. If a major credit card company has approved the individual for credit, he or she is probably a good risk.
  - You may ask a young customer (generally one from 16 to 18 years of age) to provide an endorser or co-signer, usually a parent. This co-signer is responsible for the bill if the young person fails to pay.
  - If the purchase is expensive, you can ask for a substantial down payment on the item before granting credit.
- 

### Notification of rejection

If you refuse a credit application, inform the person by sending a tactful letter. This rejection usually states that the application was unacceptable at the time and may include the reason for the denial. The individual can then contact the credit bureau to see his or her record on file and correct any mistakes in the file.

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## Secured vs. Unsecured Recovery Devices

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**Introduction** Rational business owners are much more willing to extend credit if they have some assurance that they will get paid on time. Such assurance is known as security.

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**Definitions** **Secured loan** – A secured loan is one in which the party extending the credit (the creditor) obtains the rights to something of value belonging to the borrower (the debtor) from which the creditor can recover the money if the borrower fails to pay.

**Unsecured loan** – An unsecured loan is one in which the creditor has nothing to guarantee recovery of the debt.

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**Security devices** **Conditional sale** – A commonly used security device is a conditional sale, in which goods are sold with the understanding that the title remains with the creditor until the purchase is fully paid off.

Example: When you buy a car, the bank holds the title to the vehicle until you meet the financial obligation.

**Chattel mortgage** – Another method of securing loans is a chattel mortgage, or a mortgage on personal property, in which the buyer takes title to the goods but mortgages them to the seller. If the buyer defaults on the loan, the goods that are mortgaged become the property of the lender as repayment of the loan.

**Bailment lease** – A third security device is a bailment lease, under which the buyer rents the goods from the seller. When the amount of the rental payments made equals the purchase price, the buyer takes over the title to the property by paying a token amount, usually one dollar.

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## Secured vs. Unsecured Recovery Devices, Continued

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**Legal rights of the secured party**

If a debtor fails to pay the amount owed, the creditor – the secured party with a lien against the items used as collateral – has the legal right to repossess the goods. The repossession must be accomplished without breaching the peace, or causing a disturbance.

**Encountering resistance** – If the debtor refuses to surrender the goods, the secured party may either repossess them (with some exceptions) or sell them. The sale may be a public auction or a private sale, as long as the terms of the sale are reasonable.

**For consumer goods** – If the goods are consumer goods and the debtor has paid 60% of the cash price or more, the secured party may not keep the goods; the goods must be sold. The debtor is entitled to receive any surplus of the sale after expenses have been paid, the debt has been satisfied, and any other security interests have been paid off.

Note: The debtor is entitled to receive notification of such a sale, and in most cases has the right to buy the goods back.

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# Setting Credit Limits

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## Introduction

Once you've decided it's in your best interest to offer credit, the question becomes how much credit to grant an individual customer. Review the credit application carefully to establish initial credit limits.

Note: You can always raise the limit later, based on a positive payment history.

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## Increasing the credit limit

A credit limit is not the maximum amount of credit that you give a customer at one time; it's the maximum amount the customer's account is allowed to reach before you review the account. If an established customer requests a credit increase, review the following data before deciding to raise the credit limit:

- payment history
  - amount of outstanding credit
  - total amount requested.
- 

## Factors in setting limits

To prevent credit sales from exceeding profitable limits, set initial limits for new accounts and new limits for existing accounts based on these factors:

- required payment period
  - customer's past payment record
  - customer's potential for future payments.
- 

## How to set credit limits

Follow the steps below to set credit limits.

Step	Action
1	Estimate the total amount of business you can expect from the customer during the year.
2	Divide the total expected sales figure by 12 to determine the monthly sales that you expect.
3	Multiply the monthly sales figure by the number of monthly payment periods in the credit plan.  <u>Result:</u> The resulting figure is the most reasonable credit limit for that particular customer.

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## Setting Credit Limits, Continued

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### How to set credit limits (continued)

Follow the steps below to set credit limits.

#### Establishing a Customer's Initial Credit Limit

Example: Anita Casas has asked for credit with your business. She expects to purchase \$1,200 worth of merchandise during the upcoming year. The purchases are anticipated to be steady over the year, and Anita promises to pay her 90-day account promptly. Anita's quarterly credit limit should be \$300, based on the following formula:

$$\begin{aligned} \$1,200 \text{ (Expected Yearly Sales)} \div 12 \text{ (Months)} &= \\ \$100 \text{ (Expected Monthly Sales)} & \end{aligned}$$

$$\begin{aligned} \$100 \text{ (Expected Monthly Sales)} \times 3 \text{ (Months in Quarter)} &= \\ \$300 \text{ Quarterly Limit} & \end{aligned}$$

#### Increasing a Customer's Credit Limit

Example: Last year, Gordon Baker purchased \$1,200 worth of merchandise. The purchases were fairly steady over the year, and Gordon paid his 90-day account promptly. Your credit manager expects that Gordon will buy about 6% more in the coming year. Gordon's quarterly credit limit should be \$318, based on the following formula:

$$\$1,200 \text{ (Last Year's Sales)} + 6\% \text{ (Sales Increase)} = \$1,272 \text{ Expected Sales}$$

$$\begin{aligned} \$1,272 \text{ (Expected Yearly Sales)} \div 12 \text{ (Months)} &= \\ \$106 \text{ (Expected Monthly Sales)} & \end{aligned}$$

$$\begin{aligned} \$106 \text{ (Expected Monthly Sales)} \times 3 \text{ (Months in Quarter)} &= \\ \$318 \text{ Quarterly Limit} & \end{aligned}$$

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# Collections

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## Introduction

A successful collections policy requires that you detect problems and act on them as soon as possible in order to take corrective action. This rule is especially important in the area of accounts receivable – the money customers owe your business – as it impacts your own ability to manage daily operations.

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## How to collect receivables

Follow the steps below to collect receivables in a timely manner.

Step	Action
1	Prepare the invoice promptly and accurately.
2	Review outstanding credit balances on a monthly basis.
3	For bills not paid within 30 days, send a monthly statement with: <ul style="list-style-type: none"><li>• the amount owed</li><li>• any previous account activity</li><li>• the rate and start date of finance charges</li><li>• any delinquency charge assessed.</li></ul>
4	Follow normal collection guidelines for 90 days.
5	If normal collection efforts fail after 90 days, forceful collection may be the only course of action left to you: <ul style="list-style-type: none"><li>• Hire a collection agency</li><li>• Take court action.</li></ul>

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## Collections, Continued

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### Normal collection guidelines

The fundamental rule of sound receivables management is to minimize the time between the sale and collection. Any delay, whether caused by your internal procedures or the customer, lengthens this period and increases the risk of amounts you cannot ultimately collect. The following guidelines apply to collecting receivables:

- Prepare your invoices as follows to avoid any delay resulting from the customer disputing the bill later:
  - as soon as you make the sale
  - reflecting the correct amount for the sale
  - including clearly stated terms for payment (due date, amount)
  - meeting any special conditions (proof of delivery, number of copies, etc).
- Apply cash discounts for prompt payment. Especially for large accounts, you can accelerate the collection procedure by offering a 1% or 2% discount for prompt payment.
- Clearly communicate the terms agreed upon, such as the amount of any discount and the date the payment is due to qualify for the discount.
- With the monthly statement, include a follow-up letter asking if the customer has just overlooked the bill and offer to discuss the issue with the customer if necessary.
- You may decide to assess a delinquency charge to the account in order to discourage the customer from letting the account become long past due. The usual figure is 1.5% per month on balances 30 days past due, for an annual interest expense of 18%.
- Collection activities range from phone calls asking to arrange payment to forceful collection practices using strongly worded letters from a legal collection agency or attorney to threaten impending legal action.

Key point: Forceful collection is a last resort, but sometimes you will find it necessary in order to collect an outstanding debt.

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## Collections, Continued

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### **Forceful collections: a last resort**

If the customer fails to make payments or adhere to an arranged payment schedule, you can either hire a collection agency or take legal action.

**Collection agency** – A collection agency is a business established to collect past due accounts receivable on behalf of creditors. The following points apply to collection agencies:

- If you decide to hire a collection agency, you can take advantage of the agency's superior knowledge of persuasive collection techniques.
- Debtors are anxious to clear their credit record rather than further damage their credit rating.
- Collection agencies charge a fee for their services, usually 25% to 50% of the account collected, depending on the size of the account or total dollar volume of account referred to them. So although effective, this approach may be expensive.

**Legal action** – Courts may be a costly and time-consuming option. For small amounts, you may be able to settle for less expense in small claims court. But for larger amounts, you'll have to hire an attorney and file suit to collect. Either way, it is a time-consuming process.

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## Collections, Continued

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### Legal vs. illegal practices

The federal government and many states have laws protecting consumers against harassment and deceptive bill collection practices. The federal government requires the following action.

- The Federal Trade Commission Act considers it a violation to use any deceptive means to obtain information about debtors. You may not attempt to collect a debt unless you state that the purpose of the inquiry is debt collection.
- The Fair Debt Collection Act makes it a federal offense to threaten consumers with violence, use obscene language, or contact them by telephone at inconvenient times or places in an effort to collect a debt.
- Other parts of the Fair Debt Collection Act prohibit debt collectors from impersonating government officials or attorneys, obtaining information under false pretenses, or collecting more than is legally owed.
- In some states, it's illegal to inform a debtor's relatives, employer, or other close associate about a debt in order to obtain payment.
- You may not send collection letters in a way that indicates a debt is owed in order to prevent unfair collection practices and protect debtors from embarrassment and invasion of privacy.

Key point: The legal rights of debtors and recourse of creditors are strictly regulated. If you offer credit to customers, be aware of these provisions. Consult legal advisors such as government agents, attorneys, and accountants for interpretation of credit laws.

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## Collections, Continued

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### Average collection period

A major indicator of the effectiveness of your credit and collection program is the average collection period, or the ratio of the total amount of accounts receivable outstanding compared to the equivalent number of average daily credit sales.

Example: A business had average monthly credit sales of \$6,000 and outstanding accounts receivable of \$9,000. The collection period for this company is described below.

- Average Daily Credit Sales is calculated as:

$$\frac{\$6,000 \text{ (Average Monthly Credit Sales)}}{30 \text{ (Days in Month)}} = \$200 \text{ (Average Daily Credit Sales)}$$

- Average Collection Period is calculated as:

$$\frac{\$9,000 \text{ (Accounts Receivable)}}{\$200 \text{ (Average Daily Credit Sales)}} = 45 \text{ days (Average Collection Period)}$$

**Analyzing collection periods** – Compare your average collection period to the standards below in order to identify collections issues that might exist.

Standard	Description
Payment terms	If your terms of sale specify payment within 30 days and your average collection period is greater than 30 days, your customers aren't complying with the established terms and a credit problem exists.
Past history	Compare your current average collection period to previous ones to determine whether collections are declining or improving.
Industry averages	Weigh your own average collection period against the experiences of other companies in your industry to determine whether you have effective procedures in place.

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## Collections, Continued

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### Average collection period (continued)

**Formula for evaluating effectiveness** – A simple formula for evaluating the effectiveness of your credit program is comparing accounts receivable to an established target level.

Example: Your terms of sale specify payment within 30 days and the average collection period is approximately 30 days. Establish your target level at 30 days and compare accounts receivable to that standard as follows:

$$\text{Average Daily Sales} \times \text{Collection Period} = \text{Receivables}$$
$$\$200 \text{ (Average Daily Sales)} \times 30 \text{ (Collection Period)} = \$6,000 \text{ (Receivables)}$$

Your actual receivables are \$9,000, so you know that you have an excess of \$3,000 (actual receivables of \$9,000 minus target of \$6,000) in receivables requiring your prompt attention.

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### Accounts receivable aging system

Analysis of your average collection period helps you measure receivables in total. However, immediate corrective action requires identification of individual problem accounts. Apply an accounts receivable aging system to detect these problem accounts by dividing each customer's account into late payments that are 0-30 days old, 31-60 days old, etc.

Example: The table below illustrates the account for C. Brown with a total outstanding debt of \$775.02. Of the total amount, \$317.91 is 0-30 days old, \$222.63 is 31-60 days old, \$156.32 is 61-90 days old, and \$78.16 is over 90 days old.

Name	Total Due	0-30	31-60	61-90	Over 90
C. Brown	\$775.02	\$317.91	\$222.63	\$156.32	\$78.16

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# Credit Promotions

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## Introduction

Once you've formulated policy and established procedures for offering credit, plan effective credit promotions to increase credit volume. You have three main avenues to take.

- Obtain new accounts
  - Incite inactive accounts to resume buying
  - Increase sales to all customers with credit.
- 

## New accounts

Obtaining new credit customers is desirable, but some customers are more desirable than others. The most highly coveted credit customer is young, from a middle income group, and with few other accounts. There are many sources of new credit customers including:

- current cash customers
  - new residents in the community
  - newly married couples
  - customers who are open to using credit
  - people for whom your store cashes payroll checks
  - layaway customers
  - recommendations from reliable sources.
- 

## Inactive accounts

The proper handling of present customers is the best way to ensure that they'll continue buying your goods or services.

**Reason for decreased sales by credit customers** – A decrease in credit purchases may be due to improper treatment of customers by your staff. Rather than express their dissatisfaction, customers usually remain silent but take their business elsewhere.

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*Continued on next page*

## Credit Promotions, Continued

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**Inactive accounts (continued)**

**Enticements to resume buying** – When you identify customers who have stopped making credit purchases, customize your promotional efforts to entice them to resume buying your product. It might be a personal phone call, email message, or letter that thanks them for their patronage and invites them to come back. This kind of personal contact makes customers feel appreciated.

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**Increased sales**

Promotions of credit programs must be a continuing effort, because customers may be lost if your competitor lures them away. Consumers like to be offered credit privileges rather than ask for them. A year-in, year-out program of promoting credit plans will be rewarded by new accounts as well as the revival of dormant ones.

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# **PACE**

## **Program for Acquiring Competence in Entrepreneurship**

### **Fourth Edition**

#### **Cluster A – Exploring Entrepreneurship**

Module A-1 Evaluating Your Potential as an Entrepreneur  
Module A-2 Understanding the Nature of Small Business  
Module A-3 Making the Most of Marketplace Opportunity  
Module A-4 Investigating Global Markets

#### **Cluster B – Planning for Business Success**

Module B-1 Developing Your Business Plan  
Module B-2 Finding Help for Your Small Business  
Module B-3 Choosing the Right Type of Ownership  
Module B-4 Developing a Marketing Strategy  
Module B-5 Finding the Best Location  
Module B-6 Developing a Pricing Strategy  
Module B-7 Financing Your Business  
Module B-8 Addressing Legal Issues

#### **Cluster C – Business Management for the Entrepreneur**

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Module C-2 Managing Your Human Resources  
Module C-3 Promoting Your Business  
Module C-4 Maximizing Sales  
Module C-5 Maintaining Accurate Records  
Module C-6 Managing Your Finances  
Module C-7 Extending Customer Credit  
Module C-8 Minimizing Risk  
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