Country Focus: USA

Euler Hermes Collections

Ripples on the pond: Credit culture and collections in the US

By Phil Mercer, Managing Director, Euler Hermes Collections, and Joe Batie, CEO of Euler Hermes Collections North America

"Economic growth in the US, which had previously been viewed as solid, has been slow and volatile over the past few months."

Joe Batie
CEO, Euler Hermes Collections, North America

Being in debt is a fact of life in the US. Indeed it is expected. Similarly to here in the UK, it is almost a necessity to incur debt – such as through the use of credit cards – in order to have established a credit record and so secure the finance to buy a house, car or indeed any item that needs to be bought with money advanced on trust.

More than 70 percent of American adults have a credit card, according to the Federal Reserve, and in recent times, credit card spending has shown a decline, perhaps as a knock-on effect of the banks' tightening availability of credit. A recent report by the American Bankers Association revealed that the percentage of bank-issued credit cards that were 30 days or more overdue fell to an 11-year low in the second quarter of 2012, suggesting that consumers are keeping a tighter rein on their finances.

While personal debt is an area more likely to hit the headlines, perhaps the real story lies in the changing attitudes towards debt and credit in business. Generally speaking, American businesses stick to pre-established terms of trade, but that's not to say that the cracks are not beginning to appear.

Slow growth

It had been hoped that an upturn in the American economy could lead the way for a global recovery; however economic growthin the US, which had previously been viewed as solid, has been slow and volatile over the past few months, as confirmed by unemployment figures that remain high. Although the automotive industry has returned to double-digit growth, lingering problems in the construction sector show that there are still hurdles to overcome. Other sectors such as transportation are also under pressure.

According to the latest Credit Managers' Index (CMI) issued by the National Association of Credit Managers (NACM) in the US, collections activity has been buoyant. Accounts placed for collection have been on the rise since July, while the rate of bankruptcies has also increased, albeit marginally. The number of applications being made by one business to another for credit – and subsequently rejected – has risen, although perhaps not surprisingly given the current economic woes. Conversely, the amount of credit extended in successful applications has improved, so fortunes are mixed and the picture somewhat muddy.

In the first half of 2012, the average DSO across all sectors was approximately 57 days, but for durable goods and services 30-day terms are fairly common. In some instances, such as for substantial sales or special customers, these terms can extend up to 90 or even 120 days, while the other extreme can be found in the perishables market, where terms are often as short as seven days in order to cover the risk of spoilage. Some companies offer incentives and reductions to encourage prompt payment but – as with the UK – not many buyers take advantage of these offers.

Other factors coming into play, particularly reinforced by the lagging economy of latter years, have introduced a dynamic whereby some businesses have begun to take a more 'relaxed' approach to invoices. It is now not uncommon to hear of businesses that regularly extend terms without further discussion with their suppliers, and this is undoubtedly a worrying trend. Businesses are less inclined to the concept that invoices are 'due now', not appreciating that 30-day terms or indeed any period of credit is a privilege not a right.

Perhaps not surprisingly it is the larger companies that are much more likely to take advantage of their suppliers' good nature and their dependence on larger customers for trade. Cases have been reported of corporations that will only pay invoices after a minimum of 120 days and not before, regardless of any terms a supplier may wish to agree. Some companies have also been known to renegotiate the value of an unpaid invoice at a very late stage in the transaction. On the one hand this might be to protect their own credit position, and may be considered good credit management practice; on the other, it might suggest issues with cashflow that might lead to more serious difficulties and greater supplier risk.

$18,000

Average debt collected by EH Collections in the US

Usually, the first sign that a US company may be in financial difficulty is the same as everywhere: the supplier does not receive payment or indeed any response when they attempt to chase the due payment, telephone calls go unanswered, and notices go ignored. As the customer moves further into delinquency, a dispute notification may be issued.

There are a number of options available to a company that wishes to deal with the problem internally, such as adopting a more assertive calling approach and seeking verification that the goods were received. When internal procedures have been exhausted, the company may look to seek help from a third-party collections agency, understanding that sometimes the very fact that a debt has been put out to an external collector 'elevates' the debt to a more serious and more immediate level. And some of these debts can be substantial: the average debt that Euler Hermes Collections currently deals with in the US, for example, is around $18,000, but individual debts can be 10 times that amount.

As part of the collections process, a company may decide to pursue a debt through the courts, and must first register the debt with a court and provide the necessary demographic information about the business that it is suing, in addition to any documents that substantiate the debt.

A quirk in the system

A quirk in the US legal system that has been known to catch some companies off guard is that whilst a company can legally file a lawsuit against another company in any court in any state, a court in one state often does not recognise the judgment of a court in another when it comes to enforcement, so the company is then required to go through a process called 'second judgment' through the second court – a process which amounts to starting all over again! Since there is a great deal of inter-state commerce within the US, most companies tend to file in the state of the debtor to avoid encountering this problem.

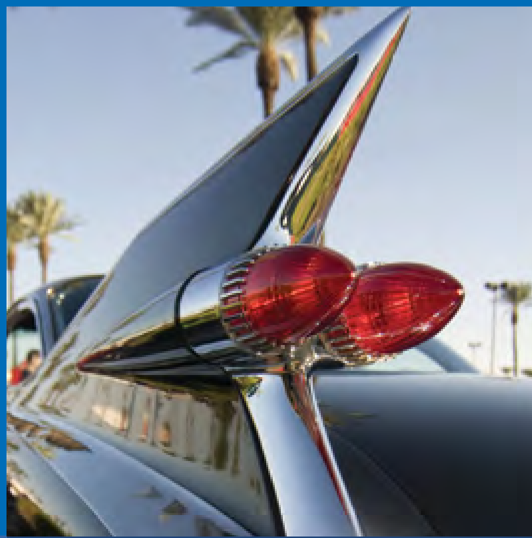
Once a lawsuit has been filed alongside the substantiating documents – such as a statement of account; invoices (copies are acceptable); and a contract or credit application that spells out the terms and conditions for the sale, e.g. ability to add interest, court costs, collection fees, etc – the court will decide what is the 'reasonable amount' that can be awarded in those areas. The company must then independently contact a bailiff's agency and contract with them to serve the debtor with the papers, after which time the debtor has anywhere between 30-60 days to file an objection or respond. It is an American peculiarity that the papers do not have be served in person, but can be served via a registered agent.

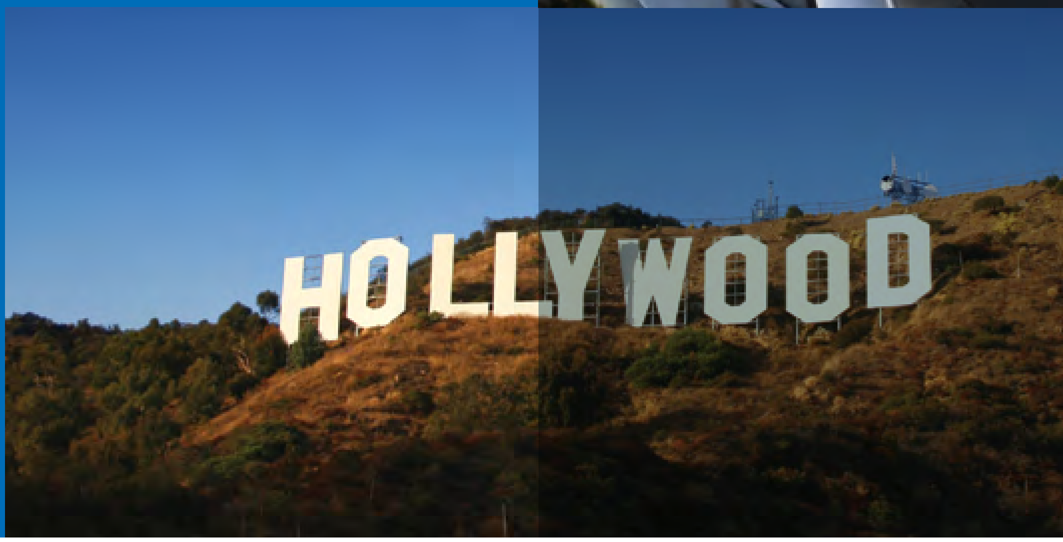
The court will establish an arbitration date or hearing once an answer has been filed and will take depositions from both sides, before comparing notes to decide on whether the charges are valid. If the court sides with the plaintiff, unless an agreement can be reached by both parties before the hearing then the fees for the court's time will be added to the debt (at the judge's discretion), so most defendants in this situation will want to avoid going to court. In the event that an answer has not been filed by the debtor, the court proceeds with a default judgment. If everything goes smoothly, the company can be executing within four to five months.

To give some idea of the scale of the challenge, Euler Hermes Collections in North America is currently working with over 6000 individuals at 1322 attorney firms to collect overdues, as attorneys do not register in multiple states. Indeed, even within a state, attorneys often do not serve all of the constituent counties; for instance, Los Angeles county is the largest county in the state of California, as a result of which there are very few attorneys there that cover any county other than Los Angeles.

The US shares many similarities with the UK when it comes to its attitude to credit, and many of its future challenges – if not directly linked to the UK – are at least inextricably linked to the rest of Europe, especially in terms of international trade. Previously robust companies, and sectors, are showing signs of stress, and businesses conducting trade with US partners would do well to ensure that their credit management strategies are more closely aligned with the increasing risk.

Since there is a great deal of inter-state commerce within the US, most companies tend to file in the state of the debtor to avoid encountering the problem of second judgment.





Euler Hermes Collections
1 Canada Square
London E14 5DX
Tel: +44 (0)207 860 2756
Fax: +44 (0)207 718 7264
Email: csc@eulerhermes.com

Euler Hermes Collections is the UK established branch of Euler Hermes Collections Sp. z.o.o,

Registered in England and Wales with no. BR015020
Registered office: 1 Canada Square, London E14 5DX