IMPORTANCE OF CREDIT APPLICATIONS AND CONDUCTING DUE DILIGENCE OF BUILDER AND GENERAL CONTRACTOR CREDIT

- Consider a new credit application for all customers or for at least those where the customer's creditworthiness is at issue.

To determine whether a prospective customer is or is not creditworthy, all subcontractors and suppliers should consider using a credit application. When you extend credit, you are, in effect, loaning customers your own money. Naturally, you want to be reasonably sure that you'll get your money back. The best assurance of future collection is to check each customer's credit history before extending credit. The credit application should be used for all new customers and periodically with existing customers.

- Review your "Bid" or "Proposal" language.

The bid should clearly state that your offer to sell is contingent upon your approving the prospective customer's credit. Otherwise, if a bid submitted is silent with respect to the credit terms, and accepted by the prospective customer, you could be in breach of contract if you fail to supply products because the prospective customer's credit was rejected.

- All credit applications are not the same.

Do not make the mistake of assuming all credit applications are the same. Even subcontractors and suppliers who currently use credit applications should compare their form against the following guidelines.

- Things to consider for your credit application.

    - What is the actual business entity of the prospective builder or general contractor customer?

    Alternatives include: sole proprietorship, a general partnership, a limited partnership, a limited liability company or a corporation?

    - How long the particular builder or general contractor applying for credit has been in business.

    - Whether any predecessor companies utilized by the principals of the particular builder or general contractor.

    This kind of information might lead you to investigate why such companies are no longer in business. In other words, did this builder operate as a previous company and form a new one because the previous company did not pay its bills in a timely manner?

    - Current trade references from the builder or general contractor.

    The information sought should include the payment terms provided by such trade references, including average credit amounts and whether any credit limits exist.

    - Bank references.

    This should include any regular banks utilized by the prospective customer and any current construction lenders.

    - Who within the applicant's company has authority to sign contracts?

    You do not want to find yourself in a position where a builder refuses to pay, claiming that the person within the company that signed the bid form did not have authority to do so.

    - Whether any lawsuits over non-payment have been asserted in the past by the company seeking credit.

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- Additional credit application best practices.

  - All credit applications should contain and refer to the subcontractor's and supplier's standard terms and conditions of sale attached

  - All credit applications should contain language to the effect that all information submitted by the builder or general contractor requesting credit is true and correct in all respects.

  - All credit applications should contain language allowing the subcontractor or supplier to disseminate information included in the credit application or otherwise obtained pertaining to credit.

  - It is a good idea for the credit application to contain a section requiring the principals of a particular builder or general contractor company to sign a guaranty.

- A guaranty is a commitment by some person or entity, other than the person or entity applying for credit, to pay the bill in the event that the applicant does not pay.

It is not uncommon to ask for a guaranty to be signed by one or more of the owners of the company asking for an extension of credit. For new accounts where the owners may be reluctant to sign a personal guaranty, one approach may be to request

- A limited guaranty vs. a specific guaranty.

A limited guaranty can be limited in amount, duration, or both. A specific guaranty is a guaranty of specific contracts or invoices.

- Cash on delivery vs. cash in advance.

Credit applications should still be used even with prospective cash on delivery customers. Why is this recommended? To the extent there are customized materials being provided, essentially they have no use if not otherwise paid for, and the supplier could still take a loss on a COD transaction. This would not be the case for customers who pay cash in advance of any manufacturing and delivery.

- Additional means by which you can verify the credit of your builder and general contractor customers.

  - Formal credit reporting companies can be used

  Although there are fees associated with obtaining credit reports. The reports show the applicant's historical payment data; bankruptcy records; any lawsuits, liens and court judgments against the applicant; and a risk rating that predicts how likely an applicant is to pay its bills. Even if the prospective customer has little or no credit history, running this type of report may still be worthwhile.

  - Good standing determination.

  Most states allow for online searches of corporate filings and whether a particular business entity is in good standing. If not, this information is usually available by telephone.

  - Call several of the trade references and ask if the prospective customer owes them money.

  With respect to the credit references provided by the prospective customer, remember that these are not foolproof. After all, the prospective customer picks its own references. For a more realistic picture, ask the prospective customer for a comprehensive list of suppliers.

  - What to ask of the prospective customer's bank references?

    - How long the bank has had a relationship with the company.

    - What is the average balance in the company's checking account?

    - Has the bank given it any credit? How much?
    - If a loan was given, did the company meet its obligations?
  - What if the credit application is not sufficient?
    - Ask the company to provide an up-to-date financial statement.
    - Evaluate the company's current assets to current liabilities ratio, called the current ratio.

    If the ratio is less than 1-to-1, the company is probably not a good credit risk. If the number is greater than 2-to-1, the manufacturer is probably safe. Of course, the financial statement itself is not foolproof unless it is audited, or if the company is publicly held and its financial statements are available for public review.

- Sometimes "no" is the most prudent answer when it comes to extending credit, no matter how much you want the business.