A,B,C & D's of In-House Financing

Tips for purchasing the quality of accounts you want in your portfolio

If you have considered the highly profitable finance end of the business and need to know how to buy contracts for in-house credit, try these simple rules. There are four qualities of contracts to buy. The A quality is very easy to purchase. That's usually the top 20% of the contracts that you look at. The bottom 20% or D quality is also easy to see, and usually rejected. The middle 60% or B and C quality are the contracts where the most money is made but need the best monitoring and better communications.

So how do you decide what credit applications to accept? What do you do if you want to extend credit to someone with so-so credit? Down payments and limited credit amounts are a good start. Use all the tools available to you such as credit applications, credit bureau reports, credit scores, and a cash flow debt analysis. Is your customer bouncing from address to address or job to job or are they stable for a reasonable length of time? Their cash flow analysis tells you if they have enough money to take on another account. If the person pay their existing obligations, the credit bureau report will tell you

Here is a step by step guide to buying contacts and evaluating your account portfolio:

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1. Do you purchase A, B, C or D grade contracts? If you buy A-grade contracts the amount of down payment is not as important as if you purchase B- or C-grade contracts. Usually a down payment is made for two reasons: First to reduce the amount of the loan, and second, to give the borrower an investment in the contract, which makes the loan stronger. The bigger the down payment, the stronger the contract is. Usually B, C and D grade contracts demand a larger interest rate, require closer monitoring, and need faster communications.

2. Credit scores are heavily used in determining the quality of a contract, but should not be the only criteria used. Credit scores are very accurate based on available information. But because so many companies do not report their customer data to the credit bureaus there are accounts that would have a reduced credit score if all the information were known.

3. Your credit decision is based on Stability, Ability to Pay, and Willingness to Pay.

   A. Determining Stability is very important. If the customer is changing addresses and jobs frequently, the risk of delinquency or default of the contract increases.
   B. Analyzing Ability to Pay is equally important. If the borrower has too much of his disposable income contractually committed, he or she will have a difficult time making payments on your contract. This is a simple analysis: you must determine the ratio of committed obligations of the family compared to the total take-home pay. In other words, how much is coming in, and how much is going out? You must consider all the fixed expenses of the borrower, including your prospective loan, and adjust the percentage ratio accordingly.

C. The Willingness to Pay is evident in the credit bureau reports. If the accounts are shown to be often delinquent, either the borrower has too many fixed expenses (he or she isn't able to pay all obligations) or chooses not to make payments. In either case, this increase s the risk of the account.

When you analyze A, B and C on the credit application you can determine the grade of contract that you have the option you write, and your credit decision is then made. If it is an A grade contract, you can choose to extend the credit amount as it is, with little or no down payment. B or C grade contracts warrant a larger down payment, or perhaps a smaller loan (you might be able to divide the sale into two parts for example). You might choose to buy C or D grade contracts only if they have a cosigner. You must always remember, "If you extend credit, you must collect it".

Another option is to use the Risk Management section of a credit management software package to track the credit scores and the debt ratio percentage of the accounts you approve. Such a package should be able to automatically grade the quality of the contracts in your portfolio so that if you find that the ratings are low- that is, your account portfolio isn't performing as well as you'd like- you can increase the credit and debt ratio data numbers as the basis for purchasing of the future accounts. This allows you to purchases the quality of accounts that you want in your account portfolio. Using these automated tools will substitute for years of experience.

. There is an old saying in the credit industry that, "You collect your account when you make it". So when you make the original contract, don't forget to ask the borrower if they can make the payment each month. Don't forget to inform them of the importance of making their payments on time each consecutive month. Instruct them that if they cannot make their payment to call you to explain why. You will be happy with the performance of your contracts if you follow these few guidelines.

If you do not have a credit policy, it is important that you make one. A good policy is to have your finance person prepare the contract for the customer's signature(s). The first thing that should be said is "Thank You" for doing business with us. Don't forget to thank the customer to reassure them that they are appreciated. Verify the terms of the contract. Go over the terms of the sale and verify the original amount, interest rate, and payment due date and payment amount. Ask if the payment date is good for them so they can have their payments on time, and verify the payment amount. Remember that if you don't set the payment policy, the customer will and you won't like their policy.

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