Common Sense Strategies for Better Accounts Receivable Management

By Andrea R. Schlack

This publication is designed to help business people determine a common sense strategy for financial success through the development of sound yet practical account receivable practices and policies. The objective is to help you get and keep the money due to you without having to try and catch it.

I

Know Your Customer: Credit Applications vs. Credit Agreements

The first critical step to better receivable management is to truly 'know your customer'. Name recognition or prior business experience is not a sufficient criterion for granting credit. All businesses fluctuate; what was good yesterday may not be true today. There are lessons to be learned from the numerous well-known companies that met their demise over the years.

"Who is this customer" and "Will I get paid"—these are the variables to be defined in all credit transactions. The proper use of an established Credit Application and Credit Agreement will facilitate your ability to verify stability, viability, and predict potential risk.

What is the difference between an application and an agreement?

Application: according to Webster's Dictionary is 'a form used in making a request'.

Agreement**:** is defined as 'Harmony of opinion, action, or character, an arrangement as to a course of action, or a contract duly executed and legally binding, the language or instrument embodying such a contact'.

Simply put, an *application* is your customer's request for terms. It provides the grantor (you) relevant, verifiable information by which informed decisions can be made. The *agreement* defines under what condition(s) credit will be extended. A properly worded agreement protects a lender's rights and remedies.

The "Forms & Letters" section of this booklet and CD-ROM provides two sample agreements that may be used as is or modified to fit your specific needs. They are:

1- Short Form Agreement, which asks your customer for the minimal basic information that a credit grantor should request in any transaction, and
2- The Long Form Agreement that includes a detailed 'terms and conditions' section that can better protect your rights when your money is at stake.

A COMPLETED AGREEMENT SHOULD BE REQUIRED OF ALL CUSTOMERS AND AN AGREEMENT IS NOT COMPLETE UNTIL YOU HAVE VERIFIED THE FOLLOWING ON EVERY APPLICATION:

- Is the application filled out completely?
- Did the customer provide you with a physical address as requested?
- Is the provided address a commercial property, a 'mail-drop' or a home-based business?
- Did your customer provide you with company ownership information, including names and addresses, as requested?
- Are the phone numbers provided actually listed to the business that is requesting credit?
- Did your customer disclose all banking information as requested and did the customer include the bank account numbers?
- Has the customer crossed out or altered any of your terms without your consent or approval?
- Are the references verifiable and of sufficient value to meet your needs?

Not all references are of equal value. As a grantor you want to distinguish which references listed by your customer could or could not 'shut the doors'. For example, if your customer is dependant on moving his product rapidly and must rely upon the freight carrier to stay in business, it stands to reason that in this scenario the freight carrier is paid before anyone or anything else.

References that are of a 'non-critical nature' will actually provide you a better impression of your customer's payment habits.

- Did your customer sign and date the agreement?

A non-paying customer costs you in many ways beyond the lost revenue in time that could have been better spent with productive accounts, and in wasted company resources.

Be very cautious of the customer who rejects or refuses your request to complete an agreement for credit or refuses to provide required application information. Credit agreements are *the* accepted business practice in today's credit-heavy society. He who refuses to provide adequate verifiable information may have something to hide.

II
The Verification Processes

Extending credit terms simply because an agreement was completed can leave a vendor vulnerable to the high risk of slow or non-paying customers.

There are numerous 'fee based' reports that provide easy to read, statistical data necessary to evaluate credit worthiness and are a cost-effective solution in making the 'quick decision'. Dun & Bradstreet or Experian reports, for example, use public records and subscriber information as well as company provided details as the basis for their statistical data. Remember that information changes over time; therefore the accuracy of any report will depend greatly upon how often report data is re-verified.

The Internet provides resources for instantaneous verification. Those same tools utilized by credit reporting companies are available to the Web-savvy businessperson at no or low-cost.

A: What's in a name?

Is your customer a corporation, partnership, or a sole-proprietorship?
The designation 'INC' or 'LLC' after a company name is not necessarily a true indicator. How your customer's business is structured can affect your ultimate rights as a creditor and being able to determine the true legal entity beforehand is helpful in determining the risk factor when granting credit.

Businesses in the U.S can operate as proprietorships, partnerships, or corporations, with each structure having its own distinct advantages. Proprietors and partners are 'owners' and do not exist separately from the assets and liabilities of their respective businesses, while corporations establish shareholders and directors who may own 'shares' but who are separate from the corporation.

Corporations need to be licensed in the state where they conduct business and are required to file regular renewals in order to maintain an active corporate status. While many businesses may choose to license elsewhere to take advantage of another state's favorable tax code they must still register in the state where they are actually operating. Businesses that are not properly registered and fail to maintain an active status put at risk the advantages that come with being incorporated.

Corporations can and should be verified with the State in which they operate. The map of the United States (located on the home page of this CD-ROM) provides easy links to the various state departments that maintain corporate records. Simply 'click' on the state of interest and then 'click' on the appropriate link. Phone numbers are also provided in the event additional information is required.

Proprietorships or partnerships are also required to register more often than not. These registrations are generally maintained by the city, county, or state and can usually be verified by contacting the department that maintains business licensing.

Did you know that?

- Credit granted to a 'dissolved corporation' may allow for creditor rights against the individual, depending upon state statutes.
- Corporations that possess no assets, much like individuals who own nothing, pose a greater challenge when attempting to enforce a creditor's rights.
- Companies that fail to maintain their corporate status may also be poor payers. Failure to maintain status could be evidence of either a poorly run business or even worse, a company that could not afford the nominal cost of filing their reports.
- Businesses that fail to provide their true names during the normal course of conducting business may not be allowed to do so as a defense against a creditor's legal rights again depending upon state statutes.
- Credit granted to proprietors or partners that incorporate after the fact is still an individual liability; however, should there be an ongoing relationship, work performed after the date of incorporation may be corporate liability unless the contract established contains a personal guarantee.

In order to maintain a low percentage of bad debts, it is recommended that credit grantors periodically re-verify and update customer information.

B: How does the Internet help when granting credit?

Over the past 10 years the business of providing 'virtual' offices such as mailbox rentals or 'common-space' office suites has grown to a multi-billion dollar industry. Mailboxes Etc and UPS have more than 5000 franchises nationally. HQ Global has nearly a thousand locations in more than three hundred cities. There are hundreds of similar companies that allow businesses to operate in disguise. While these operations cater to small and/or home-based businesses that may be very profitable and well run organizations, they also provide a safe haven for the con artist out to steal your hard-earned money. Credit grantors need to be wary of the 'bad customer'.

Does your potential customer have an actual 'bricks and mortar' location with assets? Is this customer an established business or is it someone's start-up idea that may not have the money to pay you? Is this potential customer's ultimate goal to make a profit at your expense? The web can help provide answers when used in connection with a proper credit application/agreement. The following are some helpful Internet links.

www.lycos.com

Lycos is a free, easy-to-use search engine that provides commercial phone and address information obtained through the local yellow pages or regional business directories. The 'detailed search' allows credit grantors the ability to verify a customer's address and determine if the address is a 'virtual office' or a true 'bricks and mortar' operation.

www.monstercrawler.com

Monster Crawler provides residential addresses and phone listings obtained via the local phone companies thus providing a credit grantor the foreknowledge if the potential customer is operating a home-based business.

www.google.com

Google's advanced search provides access to press releases and news articles that may effect how or if credit is extended.

Common web titles that may indicate a virtual office:

- Business Services
- Conference Centers
- Mail Services
- Office Suites
- Packaging and Shipping
- Fax Service
- Boxes and Bags
- Copying and Duplicating

If during the verification process you suspect an address is a mail drop, call the listed company and simply ask if they rent mailboxes or if they are a 'shared office space'. If the answer is 'yes' ask if your customer is renting from them.

On-line verification of public records is the fastest and easiest way to verify customer provided information. The majority of states and cities in the U.S now provide 'real-time' data on the web, usually at no cost.

The internet provides access to sites that can verify a corporation's charter, verify if its records have been maintained properly, identify shareholders, confirm current ownership, provide details of pending litigation, judgment awards, UCC searches, and other related businesses associated with your customer. In many cities you can even see driving tickets that have been issued to individuals. The web helps provide insight so that your calculated risks turn into bills paid more and more often.

In the map of the United States (on the home page of this CD-ROM), by clicking on the state of interest, you will find links and phones numbers to the various authorities that maintain records, including major cities, counties and municipal records where available. Each section provides the correct web path to the various departments as well as phone numbers, should you have any question as to how to gain access or require additional information. It also provides the statute of limitations for enforcement of a creditor's claim and a very basic overview of creditor's rights as they pertain to that state's civil codes.

Important irregularities that can impact your rights:

*Multiple corporate listings or irregularly maintained charters.
*No business licenses or registrations recorded in the state, county or city when such registrations are required.
*An inability to verify the customer provided address.
*The address verified indicates a potential home-based or virtual operation.
*The phone numbers are not listed to the customer.
*The business phone is actually a cellular number, or
*The number provided is actually non-published.

When attempting to obtain information from any search engine, remember, if the information provided by your customer does not match the search results, proceed with greater caution.

No one tool should be the deciding factory in granting a credit line; however, using no tools at all is akin to driving blind and hoping you don't crash.

III
Risk Evaluation and Scoring Credit Applications

Bad debt is a consequence of doing business. Evaluating risk is the determination of how much loss can be sustained without impeding your business' growth while still increasing your business' profits.

Eliminating bad debt entirely can cost in lost sales. Low percentages of bad debt that are disproportionate to sales may signify a credit policy that is overly conservative. Good customers who feel restrained by restrictive policies go elsewhere and can become your competitor's profit.

While restrictive policies can scare away potential customers, sustained losses due to no credit policies diminish cash flow and can negatively impact your own business' viability. Granting credit just to make the sale leaves a grantor vulnerable to slow or non-paying customers. Raw materials purchased must be paid for whether or not you have been paid. Wages must be paid regardless of when or whether the customer ultimately pays you. Time spent servicing poor-paying customer wastes valuable resources.

Balancing risk is a must for success and success can be enhanced by how applications are evaluated. When credit is granted based upon the customer's financial stability, the potential for loss is dramatically reduced.

Understanding what is an acceptable percentage of bad-debt loss is best determined by your accountant. Your financial specialists can assist in developing a growth strategy that is unique to your particular business.
Any successful growth strategy relies upon company strengths, taking into account the asset base, cash flow, sales and expenses and can be adjusted based upon the normal ebb and flow of economic trends that affect every business. The PIA/GATF Financial Ratios are another resource to help determine your company's acceptable level of bad debt. These volumes are available for purchase at **www.gain.net.**

The actual scoring of an application is very simple. Each question has a point value. Points are subtracted for questions not answered or partially answered. Answers that contradict your findings can have a subjective, positive or negative point value, depending on the nature of the question. For example, if your customer tells you they are a new company and the address provided could not be verified on-line, should that by itself reduce the score? Possibly, if your customer can provide other information, such as a copy of his newly signed lease, and you determine that the customer is in-fact a new business then the value for the address is not diminished, but the fact that 'its' a new business' should reduce the point value. Remember that new businesses are less stable financially then companies that have established track records.

Your scoring technique is akin to 'reading between the lines'; it is not necessarily what's written that should be of interest but what's not written. A primary objective during the scoring process is to identify those potential weaknesses that can impact your customer's ability or willingness to pay you when your invoice becomes due. For example, if you have asked for '*trade*' references from a 'print broker', 'trade' meaning another vendor in the same trade as you, and the references provided by your customer are for a paper company, a trucking company, and a utility company, what is your customer *really* telling you? Did your customer intentionally provide valueless references hoping you wouldn't notice? Did the customer believe these were an acceptable alternative? Did the customer fail to provide a trade reference because of a more dubious reason?

A successful credit policy is based on having these things in place:

*A clear credit policy which you provide to your customers and your employees.
*Procedures for verification.
*Scoring all applications and reading between the lines.
*Pre-determine what is an acceptable score before granting terms.
*Define what are acceptable losses.
*Periodic review of all customer provided data for corrections, updated information, and for adjustments to extended credit lines if needed.
*Adjust credit lines proportionate to the customer's actions.
*Suspend or cancel credit lines when the customer chronically fails to meet your expectations.

Losses that are not in sync with sales will have a negative impact on your profits.

IV

I Need Credit Now
Or *This Offer Valid Only Today!*

We have all experienced hard sell tactics. How we react under pressure can be the difference between profit and loss. 'I pay on time', 'you know me', 'you can trust me', 'I don't have time to wait while you verify my ability to pay', or 'if you won't give me credit now I'll go elsewhere' are the famous last words of someone who may have other, more dubious intentions. Businesses that are genuinely intent on buying your product or services, even when the order is 'time sensitive' will cooperate: their profit is dependent upon your work. It is a mutually obtainable goal.

The word ‘con’ is a derivative from the word ‘confidence’: Your job is to recognize the signs and symptoms prior to becoming a victim. Once you are able to better identify the ‘confidence game’ your chances of escaping and not becoming a statistic are far greater. Be aware of how your customer responds to your reasonable requests and be prepared to react appropriately.

In the section titled ‘Forms’ you’ll find a simple solution to the ‘hurry up’ scenario. The “Rush Order Form” can alleviate the pressure of making a snap decision. This document provides the customer an assurance that his critical project won’t be delayed by your verification process, provided he agrees to pay C.O.D should his company be deemed to be a great risk you are not prepared to accept. When providing the customer a reasonable solution and the customer is still maintaining a negative response, you can gain a greater insight as to the customer’s true intent.

V
Protect Your Interest Once Terms Have Been Established

Providing a customer with a written quote that details all applicable charges, that reiterates your credit terms, and is signed by the customer establishes a contractual agreement for the products purchased or for the services rendered. It also offers a measure of protection from a customer’s subjective memory, creates continuity of your policies and terms, and diminishes the potential risk of having to settle for less than what was actually due.

A well-written quote provides the following:

- Your customer’s complete name and address including the name of the authorized purchaser
- The date the quote was provided along with a quote expiration date
- The customer’s purchase order number when provided by the customer
- A complete job description
- An itemization of all materials including their costs
- Labor and time with the appropriate cost delineated
- Freight
- Taxes where and when applicable
- The expected delivery time

- Should there be a need for customer provided specifications and/or materials, state an acceptable timetable for their delivery to you in order to meet your customer's disclosed deadlines

- A disclosure that, should the delivery of customer provided materials to you be delayed, then your delivery time will change accordingly (always document in writing to your customer when customer provided materials have been received)

- Your credit terms, including the rate of interest charged should the customer becomes delinquent

- (Optional) A penalty disclosure that states the customer's liability for collection costs and/or attorney fees should an outside agency be employed to collect monies due.

- A disclaimer that provides your customer proper notification that he will incur alteration charges and potentially delay the estimated delivery time in the event he requests changes be made after production has begun.

- Your customer's signature and date signed

In the section titled 'Forms' there is a suggested format for an 'Alteration Request Form' and a 'Late Receipt of Materials Form' that can help protect your interest when the money comes due.

VI
Invoicing & Statements

Getting your money when due is the truest measure of success.

Invoicing your customer upon completion of their work is a straightforward process by which positive results can be achieved. If your invoicing has been delayed then so goes your prompt collection of the money due you.

Your consistency in stating your terms and conditions clearly establishes your expectation as to when payment is due. Each invoice and subsequent statement should include a re-affirmation as to your credit terms along with the defined penalties for late payments. Money that sits in your customer's account costs you potential earnings. Interest penalties charged might not amount to much on any given sale, however the annual interest lost by not charging interest compounded by the number of annual sales with delayed payment can be substantial.

Remember to include your credit terms on all invoices and statements. A typical disclosure should contain the following:

- The number of days you allow your customers to pay their bills
- The rate of interest charged for delinquent payments
- A statement that in the event an outside collection agency and/or an attorney is employed to collect any past due amounts the customer assumes liability for <u>all costs and fees.</u>

VII
It's been 31 days, where is my money?

You have taken all the necessary precautions to best protect your interest. You have completed the job, delivered it on time, the customer voiced his satisfaction, you have issued your invoice and still the money has not been received. What do you do now?

Remember, that while most customers do pay on time there will always be those who are delinquent. The following is an outline of how best to handle delinquencies. In the section titled 'Pre-formatted letters' I have provided you with several sample letters that can be used 'as is' or changed to meet your needs.

Strategy for Successful Receivable Management

- On the 31st day after your invoice has been issued, send a reminder statement. Remember to include your agreed terms along with your penalty disclosure.
- By the 35th to the 40th day, if your customer's check has not been received, a polite reminder call is warranted. If your customer requests an extension to the agreed terms for any reason you want to document the conversation. In the section title 'forms' there is a prepared form titled "Extension of Time Request Form' that can be used to document the event. The importance here is preparation for all contingencies. A customer who is unable to pay his debt may later resort to subterfuge to avoid paying what is due. A written admission of debt protects your rights should collection or litigation be required.
- On the 40th to 45th day, if your customer has failed to respond, or the answer provided was satisfactory, or the customer has failed to sign the request form, a polite letter may gain the customer's attention.
- Additional phone calls may also be needed.
- When the account has aged to 60 days, and is now 30 days past due, your second statement should be mailed. Make sure that you have included the appropriate interest charge that is now due in addition to the unpaid principal.

- If at this point you have not seen a positive result such as an agreed payment plan or a solid promise as to when you will be paid, you need to become more involved and more aggressive with your customer. If your customer's accounts payable department is unable to provide you proper, specific answers, consider speaking with a supervisor or an owner/officer of the company.

- Make several phone calls if need be. You want to speak with someone of authority. Be persistent but not abusive.

- Once you have made an appropriate contact emphasize the importance of resolution. Do not allow your customer to side-track the conversation. You want the payment that is due.

- If terms for payment are negotiated, either have your customer provide those terms in writing to you or you may use the form titled "Payment Agreement" located in the section titled 'Forms'.

- Make timely follow-up phone calls if a promised payment is not received. Remember, if you relax your efforts, so will your customer.

- If the promised payment is defaulted or is not as agreed, send a reminder letter that states the consequences of inaction should the customer continue to make and break promises to you.

- On the 90th day send your final statement. If your customer has still not cooperated, or continues to stall your payment, you need to determine what pro-active steps you will now take to protect your interest.

- Let your customer know your intent verbally and in writing:

- After the 90th day or after your third reminder statement has been issued, usually 5 to 10 days later, a final notice should be sent to those customers who continue to ignore your demands. Remember, the longer you continue to chase a non-cooperative customer the more your resources are being depleted.

In Conclusion

For more than 30 years I have spoken with countless clients who have depended upon a handshake as a dealmaker and then questioned later why they were not paid.

Fifty years ago our customers were our neighbors, they were businesses in our city, they were within our county limits. We knew them personally. Times have changed.

In the 1970's deregulation of the transportation industry allowed companies like FedEx and UPS to move our product overnight and cost effectively. Our business boundaries changed from the neighborhood to anywhere within the United States. Then with the creation of the information age, the 1990's, our boundaries grew yet again to a global economy. We no longer know our customers and it is the unknown that will impact your profits. You now have the tools to ***Know Your Customer.***