

A Sale Is Not Completed Until Collected



When you extend credit to a customer, you are stepping into the role of banker. In order to manage your company's credit risk, most companies develop a credit policy that will allow it to manage cash flow, minimize its collection risk, and facilitate customer access to products and services. A comprehensive credit policy should include the following components:

- Payment Terms
- Finance Charges
- Statements and Follow-Up Reminders
- Credit Limits
- Termination Policy
- Professional Collections and Legal Support

One of the major causes of late payments is the failure to define or adequately communicate the payment terms to its customers and staff. If customers are educated as to the importance of making timely payments, it is more likely that payments will be timely. Payment terms can be provided to your customers in writing as part of your agreement or sales order. When setting your payment terms, be sure to consider the credit rating of your customer and your own gross profit margins. If you are selling lower margin products or services, you should consider

maintaining shorter payment terms. If your gross margins are larger, you can extend your payment terms, as your company will not need to front as much capital to provide services or products.

Bankers are in business to earn interest in return for lending capital. When a customer has exceeded their negotiated payment terms, they have converted you from a vendor to banker. This receivable balance will result in your organization having to increase its borrowing and corresponding interest expense to cover the cost of goods or services provided. It is reasonable to charge customers finance charges to cover this cost of capital. Therefore, it is important that your written agreements with your customers allow finance charges to be assessed.

After assessing finance charges, make sure to send monthly statements to customers. This provides a reminder to cus-

tomers that their payments are past due and that finance charges are being assessed on overdue balances. Once statements have been sent, follow up phone calls to customers should be made to determine the reason for the delay in payment. The typical reasons for non-payment include:

- An Oversight or Lost Invoice
- Billing Issues
- Service or Product Issues
- Customer Cash Flow Issues

When a billing, service, or product issue is reported by a customer, it is criti-

cal that these issues be addressed as soon as possible. Once the issue is resolved, it is important to follow up to make sure there are no additional hurdles that will delay payment. Having a systematic invoicing system and a strong customer service focus will reduce the frequency of these types of issues.

A strong credit policy should include credit limits for each customer. Credit limits should be set based on the credit worthiness of the customer and the ability of your company to withstand a default or a delay in payment by a customer. Keep in mind that bad debt will reduce your profit, dollar for dollar. When a customer exceeds its credit limit or payment terms, it is important that your business have a policy that terminates services or shipments of additional products. Without this control, balances can grow to a point that could cause economic hardship to your company. Once services or product shipments have been cut off, and the balance remains outstanding after follow-up, it may be time to consider turning the receivable over to a professional collector or, if the size of the debt is significant, to your legal counsel.

Most organizations should expect to experience some level of bad debt in a given year. There are two acceptable methods for accounting for bad debt. Some companies use the direct method, which recognizes bad debt as payment issues related to specific invoices are identified. Alternatively, you can use the reserve method, which requires that you create a bad debt reserve based on your expected bad debt expense throughout the year. The latter method allows a company to spread out the impact of your organization's bad debt throughout the year without a material impact on any one give period.

Building a strong credit policy will improve your company's cash flow, increase your company's access to capital, and help ensure that you are building a strong and sustainable organization.

Source: Ted Rose is the President of Rose Financial Services, based in Rockville, MD. If you have any comments or questions, he can be reached at info@rosefinancial.com or 301.527.1130.

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