

# 11 Ways to Improve Accounts Receivable Collections

By Robert A. Normand

**SUMMARY: Many businesses do a good job delivering their goods and services but then find it difficult to collect payment, often causing a cash flow crunch. This may be because the credit worthiness of a customer was not properly investigated in the beginning or it may be that insufficient attention was paid to monitoring and collecting invoices due. Either way, it behooves a business owner to establish reasonable credit policies, use proven techniques to optimize cash flow and enforce terms in a diplomatic but firm manner because "the sale isn't complete until the money is in the bank". Here are eleven ways to improve cash inflow.**

## **1. Optimize Cash Sales to Avoid Risk**

There is no credit risk in cash. If your business allows for both cash payments and invoices, optimize the amount of cash, as a percentage of total sales, to the highest level possible for your industry or commercial sector.

## **2. Get Deposits Wherever Possible**

Larger sales orders, produce-to-order manufacturing and, in particular, custom orders should require a deposit of 10-50% of the final purchase price at order time. This will go a long way to alleviating cash flow shortages and to also assuring the customer's commitment to the order. Deposits of this nature should be non-refundable.

## **3. Suggest Credit Cards to Secure Payment**

Be sure you have the capability to accept major credit cards (Visa, MasterCard, America Express, and Discover). This is the next best thing to cash and reduces payment risk. In many instances, it also makes it easier for a customer to order. Customers who object to paying ahead of time may be satisfied by placing a "hold" on their credit card for the amount of the sale and processing the payment only after shipping the product or completing the service. This guarantees your payment (for a period, usually 30 days) yet doesn't appear as an early payment to the customer. For credit card sales that are processed, your company account typically is credited by the credit card processing company in 1-3 days for a service fee of 2-3.5%.

## **4. Require Progress Payments for Work-in-Progress Orders or Contract Sales**

If you manufacture a product or perform work over a long period of time, say several months, include in your sales contract specific times when payments are due (for example: 10% at time of order, 40% at 60 days, balance at completion). This will go a long way to avoid cash tightness and provide funds for continuing the project. In many contract sales situations, the amount of the deposit is effectively the profit on the order and is obtained upfront; the balance or cost of the product is then transferred from customer to vendor at normal payment terms.

## **5. Develop and Use a Credit Application Form**

Every business, large or small that engages in invoiced sales should have a credit application. This can be as simple as a one page, faxable form giving critical information such as name and telephone number of the customer's accounts payable contact, department head and chief executive. The form should also require a minimum of two trade references and a bank reference. A key administrative person (in smaller businesses this is usually the Office Manager) is delegated responsibility for obtaining the information on the form, verifying the references and suggesting a credit limit based on the findings.

## **6. Set a Credit Limit for Every Customer, Large or Small**

After credit references have been checked, a credit limit should be set for every customer. For small customers, the credit limit should be set based on their mid-level to maximum demonstrated payment performance. For large companies, a credit limit should be set based on the amount of risk your company is willing to accept and is a direct reflection of the percentage of your business you are willing to devote to one customer. Typically, concentrating over 10% of your business in one customer begins to be a risk; 30-50% is very risky and over 50% is potential disaster for your company. Bad things can happen to large companies as well.

## **7. Monitor Receivables Aging by Total and By Customer**

At least weekly, calculate the average age of your outstanding invoices by customer and total. Assign responsibility (for example, the Office Manager) for generating and reporting on this information. Develop an "Overdue" report that shows every invoice 5 days or more past your terms. Set specific, reasonable goals based on your industry for "Average Days Receivables" and tie one component of your Office Manager's compensation package to achieving the goal.

## **8. Develop Standardized Action Procedures for Overdue Invoices**

Develop a formal, written collection procedure including scripts or guidelines to be used when contacting customers who have outstanding, overdue invoices. The approach taken is always courteous but increasingly firm as the overdue time increases. Typically, the first call is a courtesy inquiry only. At 60 days they may be reminded of the company's terms and at their credit is in danger, at 90 days that their account is will revert to C.O.D. and at 100 days that litigation may proceed unless payment is received immediately. If the last stage is reached, you should be prepared to follow through promptly.

## **9. Avoid Early Dunning Letters and Use the Telephone**

Dunning letters, overdue notices and account statements that indicate an overdue invoice usually do nothing but irritate a responsible customer who may have a reasonable explanation for a slow payment. Instead, it is preferable to have your person responsible for accounts receivable telephone the customer's accounts payable designee (found on the credit application) to ask if the invoice has been misplaced or there is any other problem. Typically, 80% of slow payments are resolved in this manner and a rapport is created between key personnel at both companies.

## **10. Use Discount Payment Terms Wisely, If At All**

Offering an early payment discount does not always produce the desired result. If your customer's problem is cash flow, they will be unable to take the discount. Often, customers who already pay on time will take advantage of the discount. You may properly rationalize this as an award to good customers but you've just reduced your overall profitability as a result. Discounts that are attractive to customers most often do not produce a favorable offset in the time-value of money to your company. Better to poll your slow pay customers first and individually, to determine what the potential value of discounting might be to your cash flow.

## **11. Use Your Accounting System to Help Manage Credit and Accounts Receivable**

Many small businesses use simplified accounting systems such as QuickBooks® or Peachtree® and these systems are capable of reducing the amount of time required for accounts receivable management. Credit limits can be set by customer and the system will provide a warning message on entry of a new order should that order cause the limit to be exceeded. Aging reports by customer can be generated in a variety of formats. Data can be exported directly to an Excel®

spreadsheet and further analyzed if desired. Invoice data can also be directly exported to a customer via fax or email saving considerable time. Current customer contacts and telephone numbers are included in customer records and can be quickly extracted and used in screen reports to aid in collection calls.

Be sure you are using all the features of your accounting system to help your effort in managing credit and accounts receivable.

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