

**Common Sense Strategies for Better Accounts Receivable Management,
or
Learn To Make Lemonade When All you Get Are Lemons**

By Andrea R. Schlack

Introduction

I remember an old joke about three businessmen debating the best way to pay their taxes and still maintain a profit.

The youngest of the three declared that he was going to break with tradition-he would draw a straight line directly in front of his desk and would stand, straddling that line: one-foot on either side. He explained how he would carefully toss the money earned straight up into the air as high as possible. The money that fell to the left of the line he would pay as taxes and that which fell to the right he would keep.

His elder shook his head and claimed that there was a time-honored tradition for the proper way to declare taxes and profits. The accepted way to determine what was kept and what was paid was to draw a circle, stand in the middle and then toss the money into the air. The money that fell inside the circle was paid to the taxman, while any money that fell outside was deemed profit.

The third, the oldest and wealthiest yet, just smiled and said, “You have this all wrong. You don’t need to draw circles or lines; there is no mystical way to divide the money. I have for many years simply tossed my money into the air, knowing that the taxman would keep whatever he wanted.”

This is a fun story, but we know that’s not how the taxman operates today.

The goal and purpose of this publication is to help business people determine a common sense strategy for financial success through the development of sound yet practical account receivable practices and policies so you can keep the money that is yours.

I

Know Thy Customer: Credit Applications vs. Credit Agreements

The first and most critical step to better receivable management is to ‘know your customer’. Name recognition or a 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 have seen their demise over the past several 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 application and 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 provides a sample agreement which may be used as is or modified to fit your specific needs.

****A completed agreement should be required of all customers****

VERIFY THE FOLLOWING ON ALL APPLICATIONS:

- **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?**
- **Did your customer sign and date the agreement?**

A non-paying customer costs you in many ways—in 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. Of course, information obtained from the actual source should be the most up to date.

A: What’s in a name? or A rose by any other name would smell as sweet.

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 of corporate status. The true organizational structure of a potential customer can affect a vendor’s ultimate rights and knowing what the entity’s legal structure is beforehand can be helpful when determining risk.

Businesses in the U.S can operate as proprietorships, partnerships, or as 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 and file regular renewals of that license in the state where they conduct business 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.

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.**
- **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 prior to incorporation 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.

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. Here are a couple of 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 phone number prior to extending credit.

www.monstercrawler.com

Monster Crawler provides residential addresses and phone listings obtained via the local phone companies. It affords the creditor an opportunity to see if the potential customer is actually operating as a home-based business.

Some 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. If the answer is ‘yes’ ask if your customer is renting from them.

‘No’ is always the answer to a question not asked.

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 profit more often.

In the section entitled “Secretaries of State” you will find an alphabetical listing of states and their web-site addresses. Each section provides the correct web path to the departments responsible for maintaining corporate records and their 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.**
- *An inability to verify the customer provided address.**
- *The address verified indicates a potential home-based 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 if or when the customer ultimately pays you. Time spent servicing a poor-paying customer is valuable resources wasted.

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 people can assist in developing a growth strategy that is unique to your particular business and relies upon your strengths, taking into account your 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 actual scoring of an application is very simple. Each question has a point value. Points are subtracted for questions not answered or partially answered. Points for answers that contradict your findings can be subjective depending on the nature of the question. For example, if your customer tells you they are a new company and the address could not be verified on-line, should that in itself reduce the score?

Information and tools needed for developing a successful credit policy:

- *Define your credit policy to your customers and your employees.**
- *Create procedures for verification.**
- *Score all applications and read between the lines.**
- *Pre-determine what is an acceptable score before granting terms.**
- *Define what are acceptable losses.**
- *Review all customer data periodically and adjust credit parameters as 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 forms folder I have provided 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 greater a risk than you are prepared to accept. When providing the customer a reasonable alternative to their negative response you can gain a greater insight as to their 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 if provided**
- **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 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 when customer provided materials have been received)**
- **Your credit terms, including the rate of interest charged if 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 Forms Folder 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 simple process by which positive results can be made. If your invoicing is delayed, then so goes your collection.

When providing customers with consistent standards, you have better defined your rights. 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 too 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 all costs and fees.**

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 that are delinquent. The following is an outline of how best to handle delinquencies. In the 'Pre-formatted letters folder' I have provided you with several sample letters and payment request forms 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 which includes the agreed terms along with the penalty disclosure.**
- By the 35th to the 40th day, if your customer's check has not been received, a polite phone call as a reminder is warranted. In the forms folder I have prepared an "Extension of Time Request Form". The importance of this document is as a 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 not of value, or he has refused to sign the request form, a polite letter may gain the customer's attention.**
- Additional phone calls may 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, more aggressive phone calls should be placed to your customer. If your customer's accounts payable department is unable to provide you with a date that you will be paid, 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 and you want to know when you can expect it.**
- **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 Forms Folder.**
- **Make timely follow-up phone calls if the 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, you need to determine what pro-active steps you will now take to protect your interest.**
- **Let your customer know your intent either verbally or in writing: You will not allow him to continue to abuse the privilege granted him when you extended credit to him.**
- **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 of your resources that 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 primarily our neighbors; they were businesses in our city; they were within our county limits. We knew them personally. Times have changed.

In the 70's deregulation of the transportation industry allowed companies like FedEx and UPS to move our product overnight cost effectively and our business boundaries changed from the neighborhood to sales anywhere within the United States. Then with the creation of the information age of the 90's our boundaries increased yet again to a global potential for sales. We no longer know our customers. It is the unknown that will impact your profits. You now have the tools to Know Your Customer.