

Getting Paid: Sound Credit Policy and Collection Procedures

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Nearly every company offers credit to its customers. If you provide a good or service before receiving payment in full, then you are extending credit. For many companies, extending credit is an essential part of the business. Losses, then, will be normal as well. Still, losses should be minimized. Every business owner should know the normal level of bad debt loss for companies of their type. If you don't, obtain the data from your trade association. If, after doing some research and comparison, you are unhappy with your loss rate, consider revising your credit policy and collection procedures.

To begin, gather ideas and examples from your accountant and peers. Consult your attorney regarding collection laws, and check with your trade association for policies and procedures tailored to your type of business. Consider the following suggestions as well:

What are the essential elements?

- 1) *Qualify the customer:* Identify the types of sales or services that are causing unacceptable collection losses, or could in the future. Consider how this risk could be minimized. A good place to start is checking the credit ratings of new customers that request credit from you. Checking a company's credit rating is very inexpensive and easy. See *How to Check the Credit of Companies and Individuals* in the next issue of *The Business Owner*.
- 2) *Set credit limits:* Regardless of the apparent credit strength of any new customer, set credit limits that keep the risk that you bear to a manageable level. Review the limits periodically in light of payment performance. Keep in mind that even the seemingly strongest companies in the world can suddenly go bankrupt (e.g. Enron, Penn Central, Kmart, Polaroid, Etc.). Don't bet your company on the future solvency of any single customer, or that a receivable won't come under dispute.
- 3) *Don't give customers reasons to delay or dispute:* Make sure each sale is recorded accurately and is supported by a purchase order signed by the customer. All purchase orders should obligate the customer to your terms of sale and payment. Be sure that the order is processed without errors and shipped on time, and that the invoice is correct and delivered in a timely manner. Don't give a customer any reason to dispute the order or bill, and control the terms of payment.
- 4) *Work out any problems:* If an item is disputed, address it immediately. Find out the exact nature of the problem, and then take steps to remedy it. If the customer promises to pay, insist on specifics. What day will it be paid? Offer to pick up the payment on that date. If the customer offers to pay a partial amount, today, accept it. If a customer is in financial difficulty and the amount due is sizable, try to get a formal note executed for the full amount due with a specific repayment schedule and interest rate.
- 5) *Don't Be Forgotten:* Your collection procedures should include built-in reminders and action steps. For example, a written reminder should be sent as the due date

approaches. If payment is not received within a few days, an email should be sent or a call should be made. If the due date passes, call the customer promptly.

6) *Steadily raise the level of firmness:* While being sensitive to the particular circumstances, the level of firmness should be steadily increased as the receivable becomes more dated. Begin by sending the customer a letter, on company letterhead and with your attorney visibly carbon copied, requesting immediate payment. If the desired response is not obtained, have your attorney send a letter on his or her letterhead explaining what will occur if the bill is not paid. Be sure you follow through as asserted.

7) *Time really is money:* The longer you wait on past-due accounts receivable, the less likely you are to be paid. Statistics show that once a receivable is 120 days past due, 20 percent will be lost. When a receivable falls to 180 days overdue, the loss increases to 33 percent. The chance of collecting a one-year-old bill is about 50-50, and only 25 percent of receivables over two years old will be collected. Collect as fast as you can. Start by building into your system ways to get your cash up-front or very quickly. Offer to take payment at the time of order, you might be surprised by how many will do so. Consider offering a 1 percent or 2 percent discount on all invoices that are paid rapidly, such as within 10 days of invoice date. For more, read *Should You Offer an Early Pay Discount?* in the next issue of *The Business Owner*.

Bringing it all Together

Credit policy and collection procedures can make or break a company. The best systems are both smart and savvy. Use this article to establish smart systems that put you in the best possible position for being paid, then read *Philosophy of Trade Receivable Collection* below to incorporate the savvy. Be sure your new policies and procedures are integrated into the operations of your company, and train your employees as to their implementation and importance. Discipline yourself to enforce them and demand that others in your organization adhere to them. Together, you will have a system that will keep collection loss to a minimum, especially during difficult economic times when collection problems become more prevalent.