Part of The Working Capital Management in Practice Series

TRADE RECEIVABLES

A practical guide to optimize your trade receivables

January 2018

NORSK ARBEIDSKAPITAL

The N|A Working Capital Management in Practice Series

Optimizing your trade receivables
Optimizing your trade payables
Optimizing your inventory
Performing working capital diagnostics

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Introduction

Late payments from customers happen frequently – it's critical to the financial health of your company to minimize them. Customers who fail to pay their invoices or drag their feet in paying can directly jeopardize the survival of your business. And though medium and large companies are better equipped to absorb a bad debt loss, non-payment events can still destroy their profit and spoil growth plans. By employing effective credit management practices, you can help your business bring in the revenue it's entitled to and ensure long-term business continuity. For companies looking to take on the daily challenge of credit management, here are five important activities to optimize your trade receivables level.

Credit check

A sale is not a sale until the invoice is paid. When credit is extended to a company that cannot or will not pay, the impact directly impacts the seller's bottom line. Therefore, before you extend credit to a customer, check the buyer's credit history to ensure he pays bills on time. Also, as you create a customer account, clearly document and explain the terms to your customer before a purchase is made.

Many businesses find it however challenging and time consuming to properly evaluate and track the creditworthiness of new customers. Luckily there are several tools available to check the creditworthiness of a potential customer. Below you find a list of the most known companies that offer commercial credit information services:

- Experian
- Dun & Bradstreet
- Equifax

Based on the credit score you can set a specific credit limit in your system. Be aware that just because a rigorous credit check was completed when a company first became a customer does not mean that the analysis is good forever. Make sure you review the credit worthiness of your (top) customers every year!

Payment terms

An important element of the invoice is the payment term. The payment term indicates when an invoice is supposed to be paid. It is therefore important to set clear payment terms for your customers. These terms are generally dictated by industry practices. The most common standard payment term is 30 days.

Make sure that when you set a standard customer payment term, this term is lower or, at least, equal to your average supplier payment term. You always want to prevent a situation in which you need to pay your suppliers faster than you receive money from your customers!

In practice, there will be reasons to deviate from your standard payment term. When a customer has for example a worse credit score, you might want to apply shorter terms or even the use of pre-payments (goods will only be shipped when the payment or part of the payment is received).

Remember that granting longer payment terms to customers should always be authorized by someone from the management team!

In general, you should ensure that:

- Your company has a standard payment term for its customers

- Your company has a clear payment term policy that tells your employees how and when it is allowed to override the standard term

- Your company and its customers have a clear understanding of the payment terms. Does a payment term of 30 days mean that the customer is expected to pay within 30 days or latest on the 30th day (often meaning that the cash is received a day later)

- The payment term or due date is highlighted on your invoice (for example in bold or red letters)

Invoice quickly

Invoices should be sent as soon as possible after the goods or services have been shipped or delivered. The reason for this is simple. The longer you wait with sending your invoice, the longer you need to wait for receiving your money.

Many companies make however use of so called invoice runs; meaning that the system creates invoices on a specific moment in time. This often creates unnecessary and thus costly time between the shipment/delivery of goods/ services and sending the invoice. Especially if you send a collective invoice once a month. Some customers may then enjoy an actual payment term of 60 days compared to your standard payment term of 30 days!

It is relative easy to check whether your company invoices quickly or not. Just download the transactional customer data from your ERP-system (for example 6 months of data) and check the average number of days between customer order, shipment date and invoice date. When there are substantial days in between, it is time to improve your invoicing process.

Be pro-active

Late payments from customers happen frequently. It is therefore important that you have established a rigid collection process that tells your (collection) employees what to do when. Key is being pro-active.

That means that it pays off to contact a customer a few days before a payment is due to make sure they have everything needed to make the payment – especially if the invoice is a big one. Studies have shown that the longer receivables go uncollected, the less likely they are to ever be collected, either partially or in full. So, sending a first payment reminder more than 8 days after due date day is not the way to do it.

Instead, your accounting department should be calling or emailing clients the first day that payment is late. Start with a gentle reminder that payment is now past due — this is usually sufficient to prompt most clients to pay right away. Firmer communications may become necessary if payment is not forthcoming within a reasonable amount of time, including dunning letter informing clients that legal action may commence if payment isn’t received by a certain deadline.

Make collections a top priority and enforce it by establishing a clear, concise collections strategy. Ideally, aim to intervene early. When an account slips into the past-due column, your team should be all over it and know just what to do.

Using software

Small companies with a limited number of customers and invoices can handle their collection management quite easily with the right amount of focus. But when the number of customers and invoices are becoming larger, you might consider using specific credit management software.

This kind of software can help you automate many accounts receivable processes. The more than you can remove the human element, the more accurate and reliable the entire process will be. Many programs are expensive, but the return on investment is considerable as there are fewer errors and, in many cases, employee productivity gets a boost too.

An example of a provider of this kind of credit management software is Onguard. They are market leader when it comes to innovative solutions for order to cash.

Getting your cash

Whether you need to restructure your entire accounts receivable function or simply want to improve your collection management, the process begins by understanding your current situation through conducting an analysis of your transactional data.

From there, you can identify the steps you need to take to structurally improve your accounts receivable level.

Beyond simply helping you identify areas for improvement, the working capital professionals of Norsk Arbeidskapital work with your teams to implement new processes, monitor and track your performance and share specific action items your employees can take to optimize your accounts receivable processes.

You work hard to earn your cash. Isn't it time to get your cash working hard for you?

NORSK | ARBEIDSKAPITAL

www.norskarbeidskapital.no
info@norskarbeidskapital
Norsk Arbeidskapital
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