

The Art of Getting Paid

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How you can
convert your
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from the customer's
"pay later" pile
to the "pay
timely" pile

A spreadsheet of aging accounts receivable has been sitting on the corner of your desk for two days. It may be there another day or two before you can bring yourself to look at it. You know it won't be good news. It's really a question of how bad the numbers are. If this sounds familiar, this article is for you.

Times are tough. Customers are paying their bills very slowly, if at all. But there is always a select group of bills that get paid, even by companies having trouble. How can you increase the chances that your bills will be paid? How can you convert your company's invoices from the customer's "pay later" pile to the "pay timely" pile?

Steps can be taken to raise the odds of keeping your accounts receivable current. Pay careful attention to the collection component of your business relationships with your customers by focusing on the following: 1) the initial due diligence; 2) the day-to-day business practices; and, 3) the problem-handling phase.

Due Diligence

Due diligence is an investigation of a prospective customer that reveals information about the people or company with whom you are about to do business. Some companies call it a background investigation, while others refer to their due diligence as a credit check. Whatever the name, the resulting information is invaluable. Armed with this knowledge, you can tailor your transaction in a way that reduces the risk of late payments.

First, determine who will be responsible for the debt. If the prospective customer is a sole proprietorship, check fictitious business names. If it is a partnership, determine who are the partners; general partners are usually liable for partnership debts. If it is a corporation, take a hard look at the economic viability of the company. Don't be blinded by prosperous entities that may be associated with the company. Corporate officers, directors, shareholders, subsidiary corporations and a parent corporation normally are not liable for their company's debts.

After you know who the prospective customer really is, turn your attention to the issue of whether it has the ability to pay. An order for \$100,000 of product may provide short-term excitement, but does considerable long-term harm if the customer cannot pay for the order. Due diligence quantifies the risk. It permits you to make an informed decision whether the customer will actually pay the bill.

Look at the customer's assets and liabilities. Are they operating in the black or in the red? What is their cash flow position? Analyze their financial statements, paying particular attention to the balance sheet and income statement. Do they own real property or buildings? What personal property do they own? Who are their customers? What is their historical payment record? Are they involved in litigation?

"Wait," you say. "I can't ask my customers to give me this kind of information — especially a new customer." Why not? Try getting a bank loan without completing a loan application and providing this very information. Department stores won't issue a credit card until you give them financial information. Most significant sales, after all, result in a promise to pay for the goods sometime in the future. The key is balance. Measure the amount of information required by your actual need to know in light of the credit terms and size of the sale.

Business Practices

Set ground rules — tell customers when payment is expected. A fully informed customer will be able to make fewer excuses for late payments. Most companies already do this but get in trouble because their day-to-day business practices vary from their stated rules. "Net 30 days" doesn't really mean that payment is expected in 30 days because it's not enforced. A *de facto* grace period emerges.

The accounting department must communicate with the sales department and sales must talk to accounting. It's easy to take a myopic view of what's important. For a salesperson, it's to make sales. For an accountant, it's to collect receivables. Working together, as is usually the case, works best for everyone.

For example, if a salesperson hears that a customer may be experiencing financial trouble, he or she should tell accounting.

Accounting, at a minimum, will want to keep a close eye on the account to make sure it stays current. If accounting discovers that a customer isn't paying its bill, the sales department should be informed. Selling more product to a customer with a delinquent account only exacerbates the problem.

Handling a Problem Account

No matter how comprehensive the due diligence or how careful the adherence to collection policies, accounts become delinquent. When this happens, do the obvious: ask for payment. This sounds simple enough, but most people don't do it because they hate to ask for money. It's uncomfortable.

Begin with a letter stating the amount due then schedule a meeting to collect the money. When you meet, don't confuse aggressiveness with effectiveness. Do not be abusive. The small advantage that may be gained by such tactics is far outweighed by the risk of a lawsuit for unfair debt collection practices.

If the customer can't or won't bring its account current, you must decide whether to continue to do business with that customer. Your decision will affect the options available to you down the road. For example, you cannot sue a customer and hope to maintain a stable business relationship.

Do not continue to sell based on a promise of future payment. If a customer isn't paying, don't sell more product without some assurance of payment. For example, negotiate a repayment plan supported by a promissory note for the outstanding balance or require that a third party guarantee payment.

Another option is to make new shipments on a cash-only basis, with a small percentage of the past due amount added to each invoice. Alternatively, obtain a security interest in personal property or a trust deed on real property.

Although it may be impossible to do business without encountering bad debt, careful attention to the collection component of your business relationships will give you the power to minimize uncollected receivables. ■