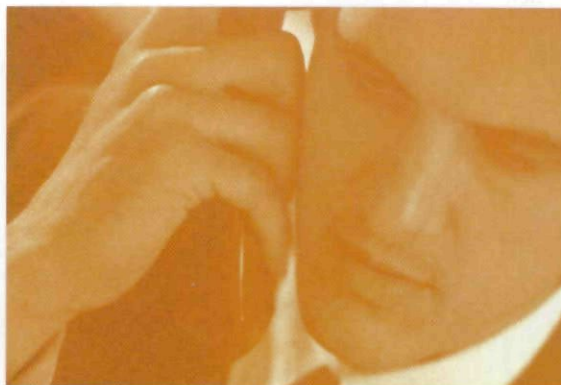


Best Practices: Collections

Best Practices—the name implies a challenge in itself. If we had always maintained best practices for our endeavors and stuck to them, we would still be rubbing two sticks together to get a spark; but thankfully there have always been those that were willing to challenge any best practice approach and offer new techniques. Having said that, my first point to any best practice policy is to remain flexible. I know some will say that this contradicts the concept itself, but it's wise to always allow some flexibility for growth, change and innovation. However, along this line I would like to focus on one area within the management of credit, and that involves collections.

Before the Sale

Prepare for the best collection department your company has ever had. That should be reflected in your thoughts, your goals and your attitude. Be proactive, anticipate the need. To start, always remember that the best practice for collections happens before the account is past due, and even before the sale. Be sure to have a solid credit application on file for all new accounts. Make it specific for your industry and review it with a good collection attorney so they can give you suggestions on what they need in the event the account goes legal. I



You want to have a separate section for the guaranty and a separate section for another signature authorizing you to pull consumer reports “for the purpose of granting credit to the business stated above” or some such wording. (I have this verbiage in the terms section in addition to including it in the personal guaranty.)

Include on your application a field for the accounts payable contact with their direct line, if possible, or some other way to communicate with them; and when setting up new accounts, be sure to include all this contact information. Collectors spend too much time trying to get valuable information that should have been gathered at the time the account was set up. If you have to, implement a new company-wide procedure on setting up new accounts so you get all the information you need at one time. Pretty basic stuff, but you would be surprised at how many companies skip these simple, yet valuable, steps.

Collectors spend too much time trying to get valuable information that should have been gathered at the time the account was set up.

know for a fact that I will have bad debt each year, I just don't know which accounts will default. So, by having a general policy in place to get an application on all new accounts, we will be covered in the event of default. Also, always get a new application in the event of a name or address change. (Be sure that the person signing your application is authorized to do so; you may want to have verbiage in your terms section addressing this issue.)

If you are able to get a personal guaranty from your customer, then certainly do so as this will always give you greater leverage. I have my personal guaranty below my terms section on our general credit application. Be sure to research signature requirements for pulling consumer credit reports on a business owner for the purpose of business credit if you are going to use consumer reports.

Remember to use as many credit investigative tools as you are able to budget for. There are many sources you can use to obtain business credit reports, as well as consumer reports, considering you have the proper signatures in place. That way you can set realistic credit availabilities on your accounts—taking into consideration, of course, projected sales volumes.

I also use the Internet a lot when investigating a new account and look for anything that may raise a red flag. Use it, as it's a valuable resource.

One more point to mention: How many of us receive a “credit letter” from a new customer listing references, billing address, maybe their DUN's number, etc., thinking that will suffice in place of the application? I'm sure

we all get these but it's not good enough. Just remember, *before the sale* the credit application is an informative document; *after the sale*, and when the business goes bad, the credit application becomes a legal document. I'm not a pessimist, just a realist—remember that you will always have bad debt.

Training or Re-training Your Customers

When I first started working at my present position, no one from the credit department was making collection calls on a consistent or planned basis. Only if an account was very large, became seriously delinquent or defaulted completely, was a concentrated effort made at collections. Fortunately, the

A good collector should be able to breeze through an aging, get the easy collections and, from there, focus on the disputes, unauthorized deductions and other, more time consuming problems.

company's receivables were healthy enough to run on autopilot but it was never the best-case scenario. In fact, when I started making changes and had employees make calls, a frequent response from customers was, "Are you going out of business?" Since no one ever called on them for payment, when we finally did, it was so out of the norm that customers thought something was drastically wrong. And so it was.

By never calling customers on a consistent basis we actually train our customers to pay consistently beyond our terms. You can be sure that the accounts payable manager will tell their CFO, "We can put payment aside for XYZ Company because they never call." Wouldn't you rather have your customer saying, "We better pay XYZ Company right away because they are usually right on top of their receivables"? I think the answer is obvious.

How do you re-train your customer base? *Communication.* When an account hits one day beyond terms—*call*. I know some will cringe at that, justifying, "Why call at 30 days (assuming Net30 terms)? They're a good customer. Just leave them alone and let them pay when they can!"


There are several reasons why you want to call as soon as an invoice goes beyond terms. First, if you are re-training your customer base it's vital that you communicate your terms to your customers and let them know that you expect to be paid within your terms. Second, you will be able to identify the customers that are able to pay within terms and sort them from the customers who are really having problems. That way you can focus on the problem or "watch" accounts. Finally, by calling early you will find out about other problems sooner rather than later. This could be a shipment of defective product; a lost, missing or damaged order; or simply a missing PO

or lost invoice. Any of these problems call for action sooner rather than later. Why let the trail go cold? I never understood letting an invoice slip beyond 90 days because they are a "good customer." For goodness' sake, if they are a good customer, they would want to know if there is a problem. *Call them.* It will also let them know that you are on top of things and let them know you care about keeping their account in order.

I actually have one customer who gets upset if they have anything over 30 days and once blamed us for not getting invoices to them soon enough. When they see their statement, everything should be in the current column. If not, heads roll.

One more point about calling at 30 days, remember that the first call should be an "administrative" call as opposed to a "collection" call. You are inquiring as to what the problem is. As you know, many times you will find it's simply a missing invoice or wrong PO and you are able to resolve it easily enough. Bingo, payment received the following week. Why wait another month for easy pickings?

A good collector should be able to breeze through an aging, get the easy collections and, from there, focus on the disputes, unauthorized deductions and other, more time consuming problems. But get the easy dollars in first. Identify the problem accounts and then you have the rest of the month to focus on the difficult accounts.



eCredit
fresh perspective

Our FRESH PERSPECTIVE
helps cultivate fine decisions.

Good decisions are flavored by a variety of insights. With eCredit, you can blend our unique industry-specific analytics into your decision process. Smooth.

Sign up for a free trial at www.eCredit.com/fresh. And see how our fresh perspective will make decision making a whole bunch better.

Circle 5 on page 72.

Define the Problem

Most business-to-business (B2B) collections can be categorized into several reasons for non-payment:

1. Cash flow problems
2. Administrative problems: Missing or lost invoice, missing PO, need buyer approval, etc.
4. Your customer's policy: They won't pay until they are paid, or their terms to their vendors are N60 days
5. Unauthorized deductions
6. Default due to being out of business, bankruptcy or other serious problems

Your job as a B2B collector is to be able to identify, as soon as possible, the real reason for non-payment. Once you can identify the problems you can better organize your day as a collector. Make your calls and identify the problems. (Do the cherry picking first, as noted earlier.) Then set aside a certain number of hours a day to do the administrative work needed (getting POD's, invoice copies, etc.). Once you have these areas covered, you will know exactly how much effort you will need to work on resolving the hard issues and can focus on them.

It's all about managing your day, not letting others control your time and being properly motivated.

Remember to always document your calls and have all your documents in order. By having everything you need at your fingertips you can answer questions quickly without having to call the customer back. You will also come across as being knowledgeable and organized and it will build confidence with you as well as respect with the customer (people can actually hear your confidence, or lack thereof). The next time your customer needs something they will remember how well prepared you were and, chances are, will want you to help them again. And isn't that the goal? To communicate to the customer that you are there to help them—not just collect their overdue invoices.

Training

Be sure to keep open communication with all your collectors. This is vital. Have their individual goals in front of them at all times and encourage them to "press toward the mark." Having group meetings and training sessions can be very helpful as others explain their problems with the group, offer their ideas or offer support in general. It's a good idea to always keep the doors open for new ideas, open communication and different ways of thinking. One collector may have a "technique" for getting around a call screener or another may have found a new resource for skip tracing.

These training and meeting sessions are good to help keep your training and collection manual up to date to insure that everyone is on the same page, using all the resources available

to them and aren't duplicating any efforts. Some companies may feel this is overkill—"Just get on the phone and call." But I've found that the greater the organization, the greater the success. It's all about managing your day, not letting others control your time and being properly motivated.

Define the Goal

If your goal is to reduce your DSO by a certain number of days, then you have to account for the fluctuation in sales. Since most credit departments have little control over sales, it may not be realistic—or a fair measurement—to measure collection efforts simply by DSO alone. A simple measurement of percents of dollars over terms may actually be your best practice. If you can reduce the over 120 column by some percent each month, which also means you have to keep reducing the over 30, 60 and 90 so they don't roll over into the 120, you will have a realistic goal that your collectors can measure and control. They can see the numbers and know what accounts make up the numbers. They know what they need to do to reach those goals. Giving your people realistic goals that they can define and influence will help to motivate them toward your goals and give them a sense of ownership, which will, in part, mean more effective collection practices.

Benchmarking

Once you have defined your goal you also need to measure yourself against a meaningful standard for your company and your industry. The collection effectiveness index (CEI) is a fairly precise measure of your collection effectiveness of collecting dollars that were available to collect. A score close to 100% indicates a high degree of effectiveness. This measure compares what was collected in a given period to what was available to collect.

The formula, as provided by the Credit Research Foundation (CRF), follows:

$$\frac{\text{Beginning receivables} + \text{Monthly credit sales} - \text{Ending total receivables}}{\text{Beginning receivables} + \text{Monthly credit sales} - \text{Ending current receivables}} \times 100 \text{ FRACTION}$$

CRF will automatically calculate your CEI for you, as well as your days sales outstanding (DSO), best possible DSO, percent over 91 days, percent current and average days delinquent. Simply go to <http://www.crfonline.org/KpiCalculator/DsoCalculator.asp> to access the calculator and enter your receivables information.

However, keep in mind your company's unique situation and be prepared to set goals for individual customers if needed. If you have a difficult customer, it may be more meaningful to set specific goals for that company alone. This would also help to highlight a problem account and keep it before your collector in a more meaningful manner than if it was just simply part of a monthly formula. Be prepared to be flexible.

If you have a difficult customer, it may be more meaningful to set specific goals for that company.

Sarbanes-Oxley Compliance

Make sure you are covered in this area, as well. Does your credit and collection process have the necessary controls in place to ensure compliance with Sarbanes-Oxley regulations? Are the processes consistently applied across your organization? Make sure you review your procedures with an attorney or your tax advisor to make sure you are in compliance.

Disputes

Again, the best way to address disputes is always before the fact. Be sure your records are complete and clear. If the customer has given you a PO, make sure you follow it to the letter and if there are changes from the customer on the PO, *make sure you get any changes in writing*. Also, as mentioned earlier, any call to a customer should be documented. The more detailed the better, but be careful to have balance. You don't want to write a small novel about each call. Be detailed, but reasonable—and remember to be factual. Credit managers aren't interested in subjective comments or "feeling." You need to always enter factual information. You want to always make comments with the understanding that any third party could review your comments without you being dragged down to local district court on defamation charges.

I once had a customer that used to dispute every invoice until I started requiring a signed acceptance of terms from them before we entered the order. Since we started doing that, this customer has not disputed once and is now a well-paying customer, within terms. But I make sure to have the signed acceptance on all orders before we process them. It works every time.

The point is, be creative and be proactive. Remember that a lot of disputes are caused by our own lack of communication, and the more efficient we are within our own organization, the fewer disputes we will have to deal with.

When you have a legitimate dispute, you need to weigh the costs against the benefits of continuing the dispute. Sometimes it just isn't worth it to be "right" and you have to graciously give in to the customer's demands in the name of goodwill and future profits. Keep your margins in mind and the relationship as well—and make a point not to let it happen again with this customer. If need be, implement a new procedure on how orders are taken, or a quality control process to double check with the sales rep and the customer service rep on whatever the problem is. Look at what the dispute was, determine how it happened and then fix whatever it was that caused the "confusion." If it's something that your company was in the right about and you just don't want to "fight it out" in the name of customer relations, you may want to look at your documents and add text to protect you in the

event of such disputes in the future. For example, if you require an approval of some sort prior to the job being run, you could add text that indicates their "acceptance" of the "proof" will hold your company harmless or some such language. Again, have a good collection attorney review these documents to make sure you are covered.

We once had a dispute that we agreed to write off in the name of customer relations where we were clearly not at fault. The customer reviewed the proof and signed off on it. We ran the order and the customer didn't like it. Since they were a large account we decided to make them happy and took the loss. My point is, some disputes will happen regardless of how astute you are.

Reserves

Make sure you have an adequate amount of reserves set aside for bad debt and be able to substantiate this figure for your auditors. You will need more than just a "gut" feeling to appease most auditors, but you can, and should, include your history with your customers as part of your determining factor in allowing or not allowing an account in your reserves. With a realistic reserve set, you know you have accounted for the unexpected bankruptcy or insolvent business—as well as a few disputes. ●

Susan Rausch is corporate credit manager at MackayMitchell Envelope Company in Minneapolis, MN. She can be reached at srausch@mackaymitchell.com.



eCredit
fresh perspective

Our FRESH PERSPECTIVE
delivers juicy savings.

Don't put up with high prices cobbled together decades ago. With eCredit, you use the power of the internet to acquire, store and use information at today's prices. Tasty.

Sign up for a free trial at www.eCredit.com/fresh. And see how our fresh perspective will make collections more fruitful while sweetening the bottom line.

Circle 5 on page 72.

Copyright of *Business Credit* is the property of National Association of Credit Management and its content may not be copied or emailed to multiple sites or posted to a listserv without the copyright holder's express written permission. However, users may print, download, or email articles for individual use.