

EXPERTS' FORUM | Bank/Financial

Aging Receivables and Your Line of Credit

Your Line of Credit — \$500,000.

Advance Rate on Your Line of Credit — Up to 80% of Accounts Receivable

10% Rule — If more than 10% of a customer's accounts receivables are over 90 days old, the entire balance becomes ineligible as the basis for advance on the LOC, as it indicates the customer may be tight on cash flow and the likelihood of repayment has declined.

Current Situation — One of your key customers has an A/R balance of \$100,000. However, their A/R turnover has slipped from 35 days a year ago to 65 days today. This scenario does not take any new sales into account.

30 Days Ago

Current A/R Aging

30 days — \$50,000

60 days — \$50,000

90 days — \$0

LOC advance available based on this Customer — \$80,000

Today

30 days — \$30,000

60 days — \$50,000

90 days — \$20,000

LOC advance available based on this Customer — \$0

The above scenario is dramatic, but not at all unrealistic. Most companies have at least a few anchor customers who account for a significant portion of their revenue and profitability. And in today's environment, they (like everyone else) are stretching their dollars wherever they can—which may mean stretching out their payments to you.

Delayed receivables can have serious consequences beyond the obvious need for cash. In this case, when the oldest \$20,000 in receivables reaches the 90-day threshold, you can no longer borrow against that entire \$100,000 on your LOC. So what to do?

Let's begin with prevention and then consider some firefighting techniques.

Check their credit. Landing a major new account is exciting; it's what salespeople live for. But to paraphrase Stephen Covey, now is the time to begin with the end in mind. No sale is a sale until the money is in the bank (your bank). So a necessary part of every new sale is the credit check. The sales team needs to understand that evaluating the creditworthiness of a prospective customer is more than a perfunctory ritual performed to keep the bean counters happy. Spending hours and weeks collecting payment on products and services already consumed is not fun, nor is it profitable. (And commissions will suffer.)

The best place to start is with the prospective

customer's bank, which is typically the most current information. Some of the more basic questions involve the length of relationship, cash balances and credit extended. Other vendors can be a useful source, as well.

Pre-bill. A primary task of the sales person is to set the rules of engagement: what the customer can expect from you, and what you will expect from them. The best time to do this is at the beginning, before the first project or shipment. With a first-time project or project of size, try asking for a significant portion of the estimate upfront. The purpose is two-fold: 1) to cover your fixed costs with this new customer, and 2) to reinforce your commitment and the value of what you're providing.

Get to know the money people. With any new account, it's a good idea for 'my people' to get to know 'your people.' Make it a habit for your controller or CFO to invite a new customer's controller or CFO out to coffee or to your plant. Matching a face and voice to a vendor number can go a long way toward preventing problems and moving your invoice from the bottom of the pile to the top.

Call early. If your terms are net 30, make it a habit to place a call on Day 25: 'I just want to confirm that you've received your invoice and there's this amount due. Does that match your records?' Establishing a positive relationship can help prevent the hide 'n seek phone game and contacting them in advance can eliminate the need for the 'you're past due' call.

Help me. When you find yourself getting more excuses and promises than cash, it's time to ask for help: 'Look, I understand you're in a tight squeeze. We greatly value your business and appreciate your loyalty. Before you make your next order, we need to become current on the amount due.' Consider requiring a client that pays late to go on COD or COD plus a percentage of their outstanding balance. You could also simply put them on COD and require everything else to stay within 90 days.

Discounts. Profitability is a function not only of price, but also of what it takes (and how long) to get paid. Not every account needs or deserves the same payment terms; offering special terms can be an effective way to accelerate payment on past due accounts. The real incremental cost to you may be minimal compared to the benefit. However, use discounts with caution, as there is a fixed dollar cost for you and it can create an expectation with your client.

All of these tools can be used alone or in conjunction with each other to help keep your A/R turning efficiently, preserve your cash flow and keep your business running smoothly.



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