Effective Collection Strategies Can Improve Cash Flow

The treasury department's job of managing and safeguarding the company's cash flow begins with the task of moving customer payments into company bank accounts as quickly as possible. That's why a critical treasury responsibility is maintaining an effective collections function.

Ineffective collections can lead to excessive borrowing. And, when interest rates are rising, as they have been recently, such inefficient borrowing will hurt your bottom line.

In contrast, adopting more effective collection practices and maintaining more accurate customer data can enable you to significantly enhance your company's cash flow.

Facing Up to Credit Risk
Like all businesses, your customers are under constant pressure to improve their cash flow and profitability. One way they do this is by delaying payment to you and other suppliers. Unless you aggressively monitor your collection trends and practices, your clients will ignore your payment terms and instead pay when it is convenient for them.

Furthermore, you need to carefully evaluate the creditworthiness of your smaller customers. "Today there is a trend toward an increasing number of bankruptcies among sole proprietorships and partnerships," says Bob Scheufler, Director of Business Development and Customer Education in the Risk Management Solutions Group at Short Hills, NJ-based D&B.

Start With an Attitude Shift
Turning around poor collection practices starts with an attitude shift, Scheufler says. Rather than grumbling about slow-paying customers, businesses need to make sure they're not actually encouraging delinquent practices.

For example, he says, companies inadvertently slow the collection process when they send invoices to the wrong billing address, produce invoices with pricing errors, ship product late because of imprecise shipping instructions or fail to obtain proof of delivery from customers.

Another problem occurs when sales representatives misrepresent payment terms—saying, for example, that 60 days is company policy when in fact your terms are 30 days or less.
Worse yet, some firms fail to maintain any standard payment terms, instead offering a variety of special terms for each new prospect in the hope of increasing sales.

Maintaining more accurate customer records will improve collections, Scheufler notes. Some 20% of businesses move every year. When you fail to note changes of address, your invoices arrive days late and the cycle of processing and issuing your payment is delayed commensurately.

Another problem, especially with new customers, is failing at the beginning of a relationship to insist on payment within terms. Say your terms are 30 days and a new customer pays its first bill after 60 days. Unless you remind the customer that you expect payment within 30 days, the customer will continue to pay late.
"Customers pay slowly because we let them," Scheufler asserts.

**Collections Treatment Plan**

As a solution for slow payments, Scheufler suggests what he calls a "collections treatment plan." The plan involves clearly stated customer payment terms that are communicated not only to your customers but also throughout your own organization.

A key component of the plan is establishing a "prioritized collection matrix" that reports each customer's credit limit and rates the customer's risk of nonpayment–either as low, medium or high.

High-risk customers should get special attention. This includes all new accounts, which you should phone three weeks after the first invoice issue date to confirm their intentions to pay.

Scheufler also suggests setting up a schedule to regularly contact all customers–new ones as well as existing clients in your low, medium and high-risk groups. Call high-dollar accounts first, as they will provide the greatest impact if and when they begin paying faster.

You should maintain call reports, which enable your collection staff to chart their progress in meeting monthly goals. In addition, your collection team should be encouraged to forward to senior management relevant information they obtain in the process of making client calls.

Whether simple or sophisticated, Scheufler says, your collections process should clearly state, "This is how I'm going to treat customers." A consistent and systematic approach based on a solid knowledge of each customer's balance status and creditworthiness will allow collections staff to improve both their performance and, ultimately, your company's cash flow.