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BCMA E~CREDIT NEWS

BCMA - It is All About You!

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This month's topics...

1. Collecting on Contract Terms

Payment dates have been negotiated right into your sales contract, but the customer does not comply. Maybe somebody failed to inform Accounts Payable. Or maybe the contract payment terms conflict with the customer's standard payment policy. Whatever the reason, you have to swing into action. Here is one credit veteran's proven action plan.

"We're an original equipment manufacturer," says **Kathleen Patel**, credit manager for Vortex Aluminum, Inc. (Omaha, Nebraska), producer of custom glass-lined steel tanks for a variety of industries. "Because of the nature of our product, lead times often extend to 26 weeks and beyond so customers must provide progress payments at different stages of production according to the work that's been completed.

Progress payment options for large custom glass-lined steel tanks are 30% up front and 70% upon shipment (net 15) or 30% up front and additional payments (due immediately) at various stages of production. "After the down payment, the next increment might be at the start of fabrication," she says. "The following increment might be at the submission of approval drawings. It varies according to the contract payment terms."

Another Vortex Aluminum product line is engineered systems also for the pharmaceutical and chemical processing industries. For this product line, payment terms are based on the particular product, including lead-time, raw materials, and labor. When various vendors work on different stages of one of these products, Patel may require a 20% down payment, 20% on fabrication, 20% on skid completion, 30% on shipment and a 10% holdback billed at equipment start-up.

"We always specify that start-up should not be more than 90 days from date of shipment," she says. "If for some reason the equipment never gets started, we have recourse to bill for the final 10%. That 10% retainage gives customers a cushion of comfort when payment is due at shipment."

Keeping Tabs on Payments Due

Once a sale is approved for credit, the sales department monitors production and notifies the billing department when progress bills should be sent. Each invoice includes the date when payment is due as well as a line description (e.g., 20% at the start of fabrication). Patel faxes copies of large dollar invoices to customers' accounts payable departments 5 to 10 days before the due date. This enables her to find out if there are problems with issuing payments as agreed.

She also generates reports on invoices for large dollar amounts and concentrates on collecting these accounts. (Smaller amounts are usually for other product lines or for service, and customers are billed for what they have already received.)

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1. Collecting on Contract Terms

"I run a report that shows everything over $50,000," she says. "If the invoices were billed the previous day, I will automatically target and call those customers in the next 10 days if I don't get payment."

She talks to Accounts Payable first to ask when the invoice will be paid. If payment will be within two or three days, that is acceptable. If the invoice will not be paid for a longer period, she contacts the purchasing manager and gets payment moved up.

Typical reasons for delayed payment include:

- **Conflict with the customer's company policy regarding payment.** Accounts Payable may not have been informed about progress payments, and the invoice may have been sent through the customer's standard accounts payable process.

"They may say they need 45 days because it's their company's standard payment policy," says Patel. "I explain that they must adhere to the contract terms. Very often, I will have a conference call with the accounts payable people and the purchasing manager who signed the contract. I will get an understanding that progress payments must be paid ahead of their company's policy. Once I point that out, they usually comply; it just takes that extra measure instead of letting it go.

"Language is also extremely important. I do not reprimand customers. I just need them to adhere to the contract payment terms. That is certainly not an unreasonable request. I get them to understand that that's the only reason I'm calling."

- **Misunderstandings about progress payments.** For example, the customer's accounts payable department may be waiting for a receiver because personnel do not understand that no materials will be received.
- **Payment not approved by the purchaser.** In this case, Patel calls the individual to ensure there are no other issues that could delay payment.

Solutions

If customers cannot make a progress payment, Patel advises them of alternatives such as:

- Standby letters of credit
- Payment by credit card
- Third-party involvement. For example, the customer may be an engineering company hired by a Fortune 500 pharmaceutical company (the third party) to construct a multimillion-dollar project. Since Vortex Aluminum's contract is with the smaller firm, Patel may ask for a corporate guarantee from the larger company.

Stopping production is a last resort, according to Patel. "We use every negotiating tool possible to have effective collection," she says. "We work closely with Sales and Production to get the agreed-upon payments on an even keel so we can keep production going.

"We also look at alternatives that might help customers dig themselves out. A customer's payment history is far more critical to me than any new bank reference or credit reference."

Cancellation charges are also included in the payment terms so the company can recoup some of the cost of labor and materials that went into the job. A continuous decline in DSO, according to Patel, indicates her strategy is working.

"Because of the type of product our customers need, they have to be well-established firms, so I rarely have a customer that goes bankrupt or runs into real financial straits," she says. "Still, it takes persistence as well as the ability to identify and resolve problems before they get old and unreasonable."

2. Triple Team Collecting?

One California company has a fairly unusual way of keeping its DSO in line. One collector calls on accounts before they become past due. Another collector call on accounts that are one to 30 days past due. A third collector calls on accounts that are more than 30 days past due. And the credit manager personally calls accounts that are more than 60 days slow. The first collector's approach is to confirm that there is no reason the invoices should not be paid when they come due.

The second collector:

1. Asks if the customer received the invoice
2. Verifies the order was complete and the pricing was correct
3. Confirms everything was handled satisfactorily, and then
4. Asks that the past due balance be paid immediately.

The goal of the second collector is to prevent any invoice from becoming more than 30 days past due. Because the first collector has already confirmed that everything was satisfactory before the account ever became past due, the second collector normally has no problem in drilling in for a payment commitment.

An advantage of this approach is that the more experienced collection specialists are assigned to the more complicated collection problems. "What we find is that by the time an account becomes 60 days past due, the account either (1) requires a more experienced and assertive approach or (2) is in need of reconciliation. In either case, this is a good time for me to get involved," explains the CM.

"Experience has taught us that the older a balance due gets the less likely it is that the customer will ever pay it. Because I am personally involved before the account becomes seriously delinquent, I can head off some problems, and at the same time, I am better able to identify those customers that cannot or will not pay what they owe.

The real advantages of this four-tiered approach to collection and risk management are that it reduces DSO and helps keep customers off credit hold.

3. Check the Quality of Software Support Before Buying

If you are thinking of buying an expensive A/R software package to help you manage your receivables, here is an important criterion to consider. How much support will you need and how much are you REALLY going to get? How accessible is the support staff? How extensive is the software support? How responsive will the company be to your questions? Here is a good way to check up on the various software providers when you are in the decision-making phase.

See if they have online help available. Is it easily searchable? Are the answers complete and easy to understand?

Then leave a message with tech support, either by phone or by e-mail. (Think of a good hypothetical question relating to your situation first.) How long does it for take them to respond? How helpful, complete, and useful is the answer they provide? If the waiting time is too long or the answer is inadequate, it is probably a precursor of things to come, and perhaps an indication that you should consider taking your business elsewhere.