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BCMA E~CREDIT NEWS

BCMA - It is All About You!

March 2020

This month's topics…

1. Whose Cash Flow Is It, Anyway?

How much pressure is too much pressure to put on persistently delinquent accounts? Relentless competition forces this credit manager to ponder this question constantly, and he has developed some uncommonly effective measures for applying the amount of pressure that is needed.

"We have a cash-flow problem," the delinquent distributor tells Credit Manager Jim Gray of Stanton, Inc. (Worcester, Mass.).

"No you don't," replies Gray. "We have the cash-flow problem."

Gray's point, of course, is that Stanton is the party that has spent the money to manufacture and ship out the product, industrial use valves. The distributor ships it on to the customer, but the cost is Stanton's problem until payment comes through. And, adding insult to injury, the distributor may be in no hurry to pay because the customer blames Stanton for any delays.

How do you protect your cash flow in a situation like this? Final customers' perceptions notwithstanding, you get tough if you have to. Gray describes one recent instance where a long-time customer who had run up a large delinquency was slapped with a strict payment schedule.

Everything Stops

"His total outstanding was $900,000, with half of that overdue," he says. "I told him that he should send us a list of needs daily and that he would have to pay 10 times the value of whatever we shipped. He negotiated that down to five times, and, after he had made some payments, we dropped that some more.

Most recently, he sent in $60,000 for a $40,000 order. He knows that if anytime the product going out exceeds the money coming in, everything stops." In another instance, as a condition for continuing to ship to a delinquent account, he required the customer to send in five $10,000 checks to be held and applied against future orders when the account was brought current. Had the account failed to return to current status within a specified time period, the shipments would have stopped and the checks applied to the delinquent balance.

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1. Whose Cash Flow Is It, Anyway?

"We offer really good discount terms (2%10th + 25th Net 30), but distributors still don't take advantage," Gray says. "We've even gone so far as to point out that, if they borrowed at twice the prime rate and discounted their payments, they'd still make money."

Much as these devices help in reducing accumulated delinquencies, Gray has no illusions that the late-payment problem can be solved for good. "We're our own worst enemies," he says. "When we see opportunities to do more business, we increase shipments. The distributors expand too quickly; they run up huge debts."

This problem is particularly severe at present because sales are flat. "The valve business is very contained," he says. "There are only so many customers. To increase business you have to get it away from competitors. That means selling at next to cost to get your foot in the door."

Communicating Hourly

Under these circumstances, he continues, it is absolutely essential to keep everyone in the organization informed about the receivables situation. "I communicate daily, even hourly, with our sales and factory people," he says. "I want to try to make sure that we continue to process orders--even with distributors on credit hold--so that when the distributor meets the requirements we've set, we can ship."

The problem, however, is that the factory people have to look out for their own priorities. "They have to devote their resources to building for orders they can get credit for this month," he says. "They want sales; I want cash. It's a struggle, but we have a good team of players who understand the situation."

With the economy the way it is, Gray finds no end in sight to daily collections problems. He strives to maintain positive customer relationships while being firm about keeping accounts current.

"As hard as it is, I really do enjoy collection work," he says. "You get a feeling of accomplishment when an account comes back into line. It's even more fulfilling when a customer thanks you for being hard but fair."

2. Coming to Terms With Your Sales Contract

When Michael M. Rankin, became credit manager for Buckeye Valve USA, Inc. (Columbus, OH), he quickly discovered why the company had a DSO problem. The sales department was often offering contracts to customers without fully understanding their implications for Buckeye's accounts receivable.

"When I studied the issue more closely," says Rankin, "I found that the company -- not the customer -- was agreeing to a number of terms and conditions upon which payment was contingent. Then it was up to us to try and collect as best we could."

Rankin immediately put into action a two-step plan aimed at reducing Buckeye's problems with these contracts:

2. Coming to Terms With Your Sales Contract (Continued)

- Step #1: He met with the sales department and discussed, in detail, each contract's terms and conditions so that the salespeople would fully understand the A/R implications.
- Step #2: Rankin met with Buckeye's customers to discuss each contract's conditions, with the aim of achieving some much-needed compromises. "I discussed all the things they couldn't live with, as well as all the things Buckeye couldn't live with," he says. "Then, we agreed to compromise."

Case in point: The issue of retainage was one area where Rankin sought to achieve some accommodation from Buckeye's customers. Buckeye Valve receives a great many orders from general contractors who are building large facilities (buildings, treatment plants, etc.). In negotiating contracts with these contractors, a building's owner usually holds back 10% of the total payment until it is satisfied that the general contractor has paid off all the subcontractors, the facility is completed, and the start-up is problem-free. Once these conditions are met, the owner will release the remaining 10% to the general contractors. "In most cases, in order to protect themselves, the general contractors will, in turn, hold back 10% from their suppliers," explains Rankin. This is called retainage.

While the concept of retainage makes sense, it poses significant problems for a company like Buckeye Valve. For example, while all the valves it delivers and has installed may work perfectly, it can take up to two years for a project to come on line, because of other problems beyond Buckeye's control (e.g., problems with subcontractors or other suppliers). When that happens, the company must wait that long to collect its remaining 10%.

Rankin realized that what the general contractors really wanted was protection. Retainage just happened to be the most common way of achieving it. So, Rankin began to offer some alternatives to general contractors -- alternatives that would, on the one hand, provide them with the protection they needed while at the same time guaranteeing full and timely payment to Buckeye Valve.

Among the alternatives Rankin offered were:

1. 10% in the form of a performance bond issued by Buckeye Valve's insurance company. "The cost of such a bond is less expensive than having to wait two years to receive the final 10% of our payment," he explains.
2. 10% in the form of a standby letter of credit from a bank. "In other words, if the valves don't work, the contractor can go to the bank, present the letter of credit, and receive the 10%," Rankin says.

Payoff: As a result of offering these options, Rankin is now usually able to negotiate 100% payment from general contractors. What's more, Rankin has reduced Buckeye's DSO by approximately eight days.