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HOW TO GET PAID

Business that nearly always get paid have one thing in common: they do not take getting paid for granted. Getting paid takes work, but there are a number of strategies and techniques that can help.

The need to focus on your collection

Many people feel that the most important number on the financial statements is "Sales." Other may believe that "Net Income" is the real key to success. However, for most smaller businesses, the real key to success is the handling of "Bad Debt Expense" also called "Uncollectible Account Expense."

Looking at one month's or one year's bad debt expense won't tell you much, but looking at a series of months or a series of years can be revealing. When your bad debts or uncollectible are rising and your sales volume is holding steady, either your credit customers are increasingly unreliable, or your collection system is no longer functioning efficiently.

Memories are short, and that is especially true when it comes to debts. As unpaid debts get older, they are far less likely to be paid. In fact, some authorities suggest that only a little more than half the bills that are six months overdue will ever be paid. In other words, if you have 20 customers that in total have owed you \$10,000 for more than a year, you will probably never see \$7,500 of that money.

You need to train at least one staff member to handle your collections. Larger businesses should assign a person to do this job permanently, while smaller businesses should assign a person to spend an afternoon or two per week to monitor collection. The most efficient way to raise cash is to collect your unpaid sales.

The need to pay attention to individual accounts

Unfortunately, it is easy to ignore individual accounts when you delegate credit and collections responsibility to someone on the staff. Without your day-to-day personal attention, you won't know realize when an individual customer is not paying. Early attention is the best approach to maximize collection.



Your own accounting computer system should be able to generate a weekly report of invoices that are more than 30 days overdue. These reports can be used to build your own in-house data base that will document the credit history of your customers. When customers fall badly behind in making payments, you have to think twice about selling them more products or services before they have paid their balance in full.

Itemized Billings

One way to speed up your collections is to adopt itemized billing. An itemized bill specifically lists each portion of the bill. Because of clients complaints, most larger businesses have adopted itemized billing not only to inform the client about what services have been performed, but also to justify the size of the bill.

Itemized billing has its drawbacks from the sender's standpoint. When customers or clients have itemized details, they can more easily spot mistakes and overcharges. Although there is no hard evidence, it seems clear that billing disputes are probably increased by itemization. Additionally, itemized bills that are too detailed cause customer confusion. A poorly designed bill may actually slow down collections if customers have to call for explanations or they simply put the bill aside because they can't understand it. A surprising number of bills probably fall into this category.

Many companies include a self-addressed envelopes with their bills, which encourages prompt payment. Some send a mid-month statement, which helps the customer keep their budget in check.

Although itemized bills have their drawback, customers have come to expect them. If you haven't been using itemized billing, the change will probably speed up your collections and help you to get paid.

Cash Discounts

A cash discount is a reduction in a customer's bill in exchange for prompt payment. Experience has shown that this technique will increase your overall profits, even though your effective profit on the particular sales has dropped.

For example, assume that a business sells a \$100 item on credit, but allows a 2 percent cash discount for prompt payment. The business paid \$80 for the item and marked it up 25 percent to its sales price ($\$80 \times 25\% = \20 ; $\$80 + \$20 = \$100$). The customer who pays promptly gets 2 percent discount and sends a check for \$98. The company's profit has dropped from \$20 ($\$100 - \80 cost) to \$18 ($\$98 - \80 cost). Although the \$2 discount amounts only to 2 percent of the customer's cost, it represented 10 percent of the merchant's profit.



Despite this loss in profit, offering cash discounts will increase your profitability. Here's the logic:

1. By speeding up collections you will have less for short-term borrowing, so your interest costs are reduced.
2. Even if you do not need to borrow, you can earn interest on the cash collected, or invest more in your business

Cash discount could be offered in a number of ways, but two methods are most common.

1. Allow the customer to deduct a percentage of the sales price if cash payment is made by a particular date.
2. Wave shipping and handling costs if payment is made in cash.

Personal Contacts

Although owners and managers may establish the personal contacts, the more likely candidate is the staff person who will be taking care of collections work. You should encourage the collections person to learn as much about the customer as possible, including all about the customer business. Also, the collections person should ascertain who at the client business has the authority to approve bills and to sign checks.

If you have a really recalcitrant customer who refuses to pay a bill, a personal visit at work has been known to yield good results. But a personal visit can be a complete waste of time.

Telephone Contacts

Time for personal visits is costly, and visits probably don't work much better than other collection methods. Even standardized letters can take a significant amount of time to send. A telephone reminder has two distinct advantages:

1. It's quick and cheap.
2. It may provide other useful information.

When you call, you should have all information before you so you can discuss the debt and any dispute about the bill. You can discover things during a phone call that would never be revealed by mail. You may learn that an individual is about to be divorced. You may find out than an individual or business is about to file for bankruptcy. Both of these facts mean that you need to take immediate collection action if you want to see any of your money.

Standardized Collection Letters

Recall that speed is essential in collections work, because the longer the bill goes unpaid the less likely it is that you will ever be paid. At a minimum you should send a



bill each month. The collections person could use a red felt-tip pen to write a reminder such as: "Just a reminder..." or "Second reminder." Handwriting give this appeal a personal touch that will make certain customers feel guilty that they haven't paid on time as they have implicitly promised.

Nasty messages should be used only when you don't anticipate ever doing repeat business with the customer. For example: "we're ready to refer this account to a collection agency." Or "Act now to protect your credit rating." Or "Legal action will begin if payment is not received by"

Although second bills and individualized notes or stickers can induce payment, a well-designed reminder may be more effective. If you decide to use letters instead of phone calls, you should compose at least two: one that is a pleasant reminder and one that is firm. Your second letter should be polite but more impersonal. For those without guilt feelings, you may need and almost threatening letter, pointing out that your previous letters have been ignored.

Letters should always mention that the customer is to disregard the letter if payment has been made or mailed. If a customer received what is seen as an insulting collection letter after a late payment has been sent, you may lose a customer.

Again, the key is to treat each customer as an individual. What worked with one customer may not work with another.

When to Get Tough

You should get tough

1. After three contacts in 60 days
2. If the customer has tried to lie to you
3. If there has been a history of problems with the account and one contact has been ignored.

Generally if you send a bill, then follow up with two phone calls, two letters, or a combination of calls and letters and get no response, it's time to get tough.

If your customer has lied to you, you might as well get tough now. There's no reason to expect that person to be honest and trustworthy later. Of course you need to distinguish a lie from a "face-saving excuse." Although "the check in the mail" story is used by customers who have no intention of paying, it's also a means of saving face for those who have forgotten the bill or those who are temporarily short on cash. Don't forget that some people always show up for the party late. Some customers will be late but will always pay.



Credit Insurance

In a credit insurance arrangement a seller buys insurance from an insurance company that agrees to reimburse the seller if a customer fails to pay. The seller must pay a premium for this protection-generally about one percent of the insured accounts. If you are insuring \$10,000 of accounts, the premium would probably be about \$100.

A credit insurance policy will typically include a deductible amount. If a customer fails to pay a \$10,000 bill, the insurer will not reimburse you for the entire amount; you might be reimbursed only \$9,000 after you absorb a \$1,000 deductible. Insurance companies sometimes limit their risk by insuring only part of any customer's accounts. As with most insurance, the more risk you accept the lower your premium will be.

Generally you will want to insure only your riskiest accounts, while the insurer would like to insure all the less risky accounts. Typically the insurer will negotiate an arrangement that includes some of both.

You probably need to consider using credit insurance in the following cases:

1. One or two companies make up the bulk of your sales.
2. You have sold specially manufactured products that cannot be resold to anyone else should the buyer default.

Our Perspective

Businesses that nearly always get paid have one thing in common; they don't take getting paid for granted. Getting paid takes work, but there are a number of strategies and techniques that can help.

While it is important to pay attention to indicators such as your overall bad debt expenses, it's also vital to pay attention to individual accounts. Certain techniques can also help you get paid. The use of itemized bills can increase your chances of being paid. Cash discounts can increase your collections and profits. Personal contacts can help a business collect its bills. Telephone contacts and reminders of overdue bills are cheap, quick, and often effective. The use of standardized collection letters at regular intervals will provide a reminder to customers that they have overdue accounts. Finally, the purchase of credit insurance make sense for many companies, if the customer does not pay bills, the insurance will. The use of credit insurance is especially appropriate for major accounts.

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