Completing The Sale – Collecting Receivables

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The salesman is often satisfied with the completion of a sale. However, if his customer does not pay has an actual sale occurred? Or if the salesman implied that the customer should pay in 30 days but the customer has not paid in 60 days. Does the company have the necessary cash resources to operate?

These are some of the important issues involved with managing receivables. Just as an army can't run on an empty stomach, a company can't run without cash and generally collecting receivables are the source of most company's cash.

A business possesses many assets—a strong management team, an excellent marketing strategy, and outstanding products. But if it can't convert these strengths into cash it will fail. The receivable function is the primary vehicle to convert a company's activities into cash. This simple thought is the basis for the thought that "completing the sale entails collecting receivables."

This review will present several ideas that will allow the executive to avoid the pitfalls and potential life-threatening consequences of not "completing the sale." They are:

Knowledge

Reconciliation

Controls

Forecasting

Knowledge - As soon as a sale has been recorded, a company has created a receivable. In the perfect environment, a company will convert this sale into a receivable immediately. This often happens in a company that has an integrated computer system that automatically creates the receivable when a sale is reported. However for small companies, the existence of an automated integrated accounting system might not exist. Generally the sale is recorded when a customer invoice is created. In today's business environment, the invoice can be created with a credit card charge. No matter what vehicle is used to record the sale, the faster these documents are created the faster the company can collect cash from its customer. If the reporting of sales is delayed, the receipt of the customer's payment might also be delayed. Another element of the sale is the agreement between the seller and the buyer of the timing of the buyer's cash payment settling the invoice. This agreement is defined as the terms of sale. These terms define the anticipated time when the customer will send its payment. If no terms are established, the company will have no certainty when the customer will provide the cash. These terms are generally defined in the days from invoice date. For credit card sales it is the processing time provided by the banking institution's network. In summary the two elements in managing receivables successfully is to first prepare an invoice as quickly as possible after a sale is completed and second to define the terms of sale outlining the specific obligation of the buyer to settle the transaction.

Reconciliation - Once the sale has been completed, the next step is to insure that this sale is recorded into a receivables ledger. Ideally a company will update its lists of receivables daily. Many companies use software packages that update a list of receivables simultaneously with the generation of a customer's invoice. However many small companies do not have integrated sales reporting systems. These companies might have two separate documents-one a list of sales and a second list that lists the receivables. All receivable lists should include the agreed upon terms. Periodically during the month, the company needs to insure that all sales have been recorded in the receivables listing and that each receivable listed includes the terms of sale.

Controls - Now that the customer invoice has been created and the receivable has been recorded, the next step is to develop the mechanism that insures the customer pays its invoice. The lists of open receivables should be prepared in a way that easily indicates the timing of the customer's payment. Most managers have access to spreadsheets. In the previous step a receivables spreadsheet should have been created that lists the outstanding receivables by the agreed upon customer payment date. When the cash payment is received the file needs to be updated. If the payment date arrives and the customer has not paid, the seller needs to call his customer asking the payment will be made. This activity can be defined as the collection process. It is important that the seller not be tentative in in the collection process. He or she should not be bashful when communicating with his buyer about payments. Ideally the seller/buyer relationship will be disciplined in the sense that the buyer will pay under the agreed upon terms. Unfortunately sometimes, the buyer takes the liberty of not settling invoices according to the agreed upon terms. In those situations, the seller must communicate with the buyer insuring that payment is received timely. If the payment is delayed to an unacceptable time, the seller must be prepared to take legal action to get the buyer to pay.

When dealing with sales completed by credit card, the collection problem becomes less complicated in one dimension in that potential risk of slow payment is reduced significantly. However, the reconciliation of the payment received with the sales generated might be more difficult. Generally, the proceeds from the credit sale are deposited directly into the seller's bank account. Can the seller reconcile these payments with his knowledge of the sales? Also often the funds received are less than the actual sales due to processing fees created by the credit card process. Does the seller have a mechanism to verify that these fees have been charged directly?

Forecasting - With the elapsed time between the creation of a sale and the payment of the receivable, the company needs to have a process that allows it to forecast the timing of these cash payments against the general cash needs of the business. The first step in this process is to forecast when the cash payments will be received. This forecast should be based on the terms that were established when the sale was completed. Monthly the company should compare actual cash received against the forecast. This process can be a useful measurement of the success of the collection process. There are also some simple measurements that a company can use to measure the effectiveness of their collection efforts. For example, first develop the actual sales per day for a 30-day period by dividing the current month's sales by 30. Second, calculate the days of outstanding receivables by dividing the amount of outstanding receivables by the actual sales per day calculated in the first step. If the company's basic credit terms are 30 days and the calculation of days of outstanding receivables are between 30 and 33-35 days, the company is having little problem in collecting its receivables. But if this factor exceeds 35 days and is approaching 40 days or longer, the company has a problem and needs to become more aggressive in collecting its receivables.

In summary, several factors have been discussed:

- Create invoices as quickly as possible after sales are made.
- Insure terms of payments are clearly stated on the invoice.
- Reconcile the outstanding receivables with the sales that have been invoiced.
- Follow the collection process closely and aggressively contact buyers who have not met the agreed upon payment terms.
- Develop a measurement that analyzes the effectiveness of the collection process.
- Develop a forecast of collections and measure actual collections against this forecast. ♦

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