



Flexible But Firm: Credit Policies That Work for You and the Customer

Want to get paid faster? Communicating payment terms and conditions with your customers can make a big difference.

A common mistake many business owners make is counting receivables as cash. It is important to remember that the invoice is worthless until the customer pays it. You need that payment as soon as possible for your company to meet its goals. That is why it is crucial to have a credit policy in place that you and your customers can follow. The terms and conditions you establish for providing services on credit will drive how quickly and consistently you can turn your invoices into revenue. Here are some tips to implement when drafting your credit policy:

Know your company

The policy's terms should reflect your company's values, financial state and goals. How much do you want to generate in sales each year? How much liquidity does your company have and what is your capacity for taking on higher-risk customers? Who are your competitors? How aggressively do you want to capture market share? The ideal credit policy will support the values and ideals of your company without hampering your ability to land sales or break into new markets. It will be flexible enough for your business to land clients, but firm enough to ensure steady cash flow and only calculated risks. If you have a larger company, make sure all your department heads have a say in drafting the policy and are comfortable with what it communicates.

Know your numbers

How long can your company afford to wait on a payment? How much cash do you have on hand, and is it enough to take on higher-risk customers? Understanding how cash flows through your company and how much money you need to operate will inform your payment terms. A cash flow budget or forecast tool for understanding your company's finances and how soon you will need customers to pay.

Understand your customers

Before taking on a new customer, check that company's credit score and payment history. Do some online research to see if they have any liens, active lawsuits or bankruptcy filings. You can also create a formal credit application that asks the company to provide business references, bank contacts and financial statements. If a customer tends to pay late or if the work involves expensive labor or equipment, you might adjust terms to require a partial payment before the work begins. An effective credit policy should reflect your customers' unique challenges and pain points, as well as the industry standards in extending credit. A strict policy may benefit your company's cash flow. It may also hurt your sales if the terms are too demanding. Conversely, more lenient terms may lead to more sales, but also greater risk.

Be aggressive

The payment cycle for many industries is “net 30 days,” which means a customer’s payment is due within 30 days after a product or service is delivered. However, that does not mean that some customers will not agree to a shorter payment cycle. Test a new customer’s flexibility when negotiating terms. If you suggest payment in 10 to 15 days and the customer agrees, you may gain several valuable days for your cash flow.

Throw in some incentives

Consider rewarding early customer payments with a clause that extends a small discount. You might offer a 2% discount if they pay within 10 days. Likewise, you can discourage late payments by assessing late charges or carrying charges after 30 days. If you are performing a large project for a customer, you may structure the terms to ensure a steady flow of payments. For instance, delivering 10,000 units of a product for a one-time payment may exhaust your company’s cash flow and resources. Instead, you could agree to five deliveries of 2,000 units with payment due after each delivery.

Expect late payments

Despite your best efforts, some customers will not follow your payment terms. Big companies tend to pay late because they have enormous leverage over smaller vendors. A 2012 *Wall Street Journal* survey found that 64% of small businesses had at least some invoices that went unpaid for 60 days. A study of more than 12 million invoices by Xerox found that invoices are paid an average of two weeks late. Late payments happen to everyone. In crafting your payment terms, take the worst-case scenario into account. If a company has a history of paying two weeks days late, set your terms for 10 to 15 days. That way, you stand a better chance of receiving your cash in 30 days.

Communicate your terms

One effective way to speed up your cash conversion cycle is to negotiate payment terms with customers before you work with them. Of course, you want to negotiate terms that are as favorable as possible to your company. Include all of your payment terms and conditions on the credit application. This will ensure that a customer has read and agreed to them. Terms can also be repeated on orders, invoices and even emails related to the customer's account.

Enforce your policy

In managing receivables, outline a process for following up on accounts that are not paid in time. Develop schedules for sending out invoices and following up with collection letters and phone calls. Have a plan to reach out to the customer before an invoice becomes due, especially for larger accounts. This effort may seem like a headache, but it can save precious days for your cash conversion cycle.