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Managing the True Cost of Accounts Receivable

Managing accounts receivable and collections is no doubt the most important financial task for any organization. You work hard to sell your product or service, only to see your customers string out the payment, elongate your stated payment terms and use your working capital at their discretion.

Measuring and managing your DSO (Days Sales Outstanding) is a never ending job, no matter how thoroughly you analyze your customers at the beginning of the sales cycle. While organizational resources are critical in managing accounts receivable, companies often fail to measure the "true cost" of managing this most critical short term asset.

Taking a simplistic approach to accounts receivable optimization by utilizing the "cost of funds" or "carrying cost" methodology is flawed at its core. Why? Because carrying costs represent only a portion of the true cost of every dollar in accounts receivable. There are other factors that ultimately increase the cost of accounts receivable. They are as follows: 1) opportunity costs, 2) administrative costs, and 3) bad debt expense.

While carrying costs can be measured as simply as interest rates on lines of credit, cost of capital or working capital cost, these other 3 costs can greatly exceed the cost of funds for outstanding accounts receivable. Opportunity cost represents interest that otherwise would have been earned on other cash investments or return on capital on alternate investments. As receivables age past 30 days, opportunity costs exceed 1.00% and at 120 days, they soar to over 9.00%.

Administrative costs represent the cost to administer, manage and collect accounts receivable. For receivables under 30 days, the cost is minimal. As receivables near 90 days, the cost increases above 1.00%. Bad debt expense represents the actual write-offs of receivables. These costs increase to 2.00% at 120 days. Collectively, all of these costs greatly increase the cost to carry every dollar of accounts receivable.

At 30 days, the true cost of accounts receivable is approximately 1.63%. That is an acceptable cost level. At 60 days, the true cost increases to 4.14%. At 90 days, this cost is well above 9.00%. At 120 days, the true cost is over 15.00% and basically you have a lost receivable. What does all of this mean? People often think that the price of accepting payment cards (commercial and consumer cards) is an expensive way to collect receivables. However, accelerating the

collection of accounts receivable via preauthorized and dated payment card charges is minor when compared to the cost at 60 to 90 days for every dollar in accounts receivable.

For example, a $10,000.00 balance on a customer account actually costs nearly $1,000.00 once the receivable hits 90 days. At 120 days, it can cost over $1,500.00. Understanding and measuring the true cost of accounts receivable is critical in maximizing working capital and efficient asset management.

Vizant is an expert in optimizing all of the direct and indirect costs associated with managing your accounts receivable and all of your financial payment collections. Contact a Payments Expert today to learn more at inquiries@vizant.com or 800-498-7505.