THE HIDDEN COST OF MANAGING YOUR ACCOUNTS RECEIVABLES

Have you ever given any consideration as to the hidden costs of managing your A/R? The true cost of carrying accounts receivable is rarely calculated and seldom known. In some cases these costs are incorporated in planning at an intuitive level; in many cases they are simply ignored. When fully calculated, however, these costs can be surprisingly large.

Nothing is so debilitating to morale as working in an organization that does not have the resources to grow, or even to maintain the status quo. The result is higher personnel turnover, managerial stress, and a pervasive pessimism that in turn stifles the very motivation needed to solve the problem.

Percentage carrying cost to receivable dollar

Cost element	**30 days**	**60 days**	**90 days**	**120 days**
1. Time	0.82	1.63	2.44	3.22
2. Administrative	0.00	0.50	1.50	2.00
3. Opportunity	0.00	2.50	7.50	12.50
4. Predictability	0.00	1.00	1.00	1.00
5. Financing	0.00	0.66	1.30	1.99
6. Bad debt	1.00	4.00	6.00	10.00
Total cost	**1.82%**	**10.29%**	**19.74%**	**30.71%**

*Harvard Business Review, August 2009

> Predictability costs will differ for each company, depending on how consistent collections are. For this example, a nominal accuracy of forecasting was assumed, keeping costs constant for each period. Financing cost was based on the line of credit cost. The bad debt costs column used industry norms.

Many of the costs of carrying accounts receivable over varying time periods can easily be calculated if you would sit down and take the time but for those firms that do not have a CFO, Controller or an accounting department the job fails to the businesses' principle to figure it out.

There are a number of administrative improvements and collection routines that can be implemented at little or no expense to help improve the collection of your accounts receivable. You can:

- ✓ Offer incentives to customers to pay on time, discounts are one way but they reduce your gross margin.

- ✓ Collect money in advance based on an estimate of the product delivered. The issue with this is; you limit your availability to a larger market segment.

- ✓ Institute a minimum-payment schedule scaled to client's cash flow. If you do this you will have to add personnel to collect it or spend more time yourself collecting the payments. This adds cost.

- ✓ Establish a credit card payment program. This is a very good way to reduce you're A/R exposure but it will increase you cost because of the discounts from your card provider.

It's important to remember, all of the above options can help but the can be very costly to implement, control and could impede growth.