PAYLINK

HARD AND SOFT COSTS OF YOUR ACCOUNTS RECEIVABLES PROCESS



Every function within a company's Accounts Receivable Process has a process to complete the respective function. Every process has a cost, whether it be a hard cost (i.e. stamps, envelopes etc...) versus soft costs (i.e. labor, inefficiencies etc.).

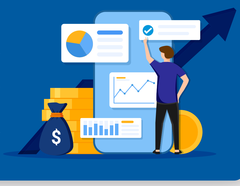
We all know that carrying accounts receivables for a company costs money. After all, every outstanding invoice on your accounts receivables represents the company's money sitting in a customer's bank account. Understanding the true cost of carrying customer debt, provides insight for management in the development or updating of the company's Credit Policy.

Understanding both the hard costs and the hidden (soft) costs provides management of a company insight on how to best improve the accounts receivables process.

The actual cost of carrying accounts receivables varies by company. But there are costs that will apply to most businesses. Here are some areas that will help define the costs associated with carrying accounts receivables.

FINANCING

The first cost of carrying accounts receivable to consider is the financing costs. If customers owe you money, you will be paying interest on bank or lending fees to finance the outstanding balances of unpaid invoices, or you will be forgoing accruing interest on an interest-bearing account. Consequently, you are paying or losing interest on the balance of AR accounts.



ADMINISTRATION

The total cost of administering accounts receivable can be significant, especially if you have any slow-payers or delinquent accounts. It takes time to chase slow payers, and there is a cost to sending customer statements and account reminders. Even reliable customer accounts will be costing you money when they have account queries. Processing invoices and payments and reconciling accounts further add to the total AR administrative costs.



COLLECTION COSTS

When your accounts receivable team has exhausted all its options for collecting an overdue account, you may have to resort to passing the debt to a collection agency, and that may cost as much as 25 -50 percent of the value of the invoice. Hopefully, you won't have too many debts that get to this stage. Even so, collection costs still need to be taken into consideration in the total cost of extending credit to customers.



BAD DEBTS

The possibility of bad debts should also be accounted for in your calculation. Your accountant will probably insist that you make a bad debt provision every year. However, a bad debt provision is not merely an accounting entry needed to satisfy your accountant's need for prudence. The provision is there because the possibility of customers not paying their invoices is valid, and the longer a customer account is outstanding, the greater the risk of you suffering a bad debt. For that reason, it would help if you considered your accounts receivable turnover ratio when calculating the potential cost of bad debts.



CASH FLOW UNPREDICTABILITY

There is also a cost in the lack of cash flow predictability carrying accounts receivable causes. The uncertainty over when sales invoices will become cash in the bank makes forecasting challenging. And, it can be harder to make decisions when you cannot be sure what the cash position will be. Ultimately, uncertainty can lead to a slower decision-making process, which may cost your business money in the long run.



OPPORTUNITY COST

The following cost to consider is a little more challenging to quantify. This is the cost to your business of not having accounts receivable cash in your bank. The money that is tied up in sales invoices could be used for a marketing campaign that generates new business, for example, or you could have invested the cash in product development. Consequently, if you lower your average days sales, you will have more money to reinvest in income-generating projects. Although, if you are carrying a significant accounts receivable balance, it will cost you in terms of lost opportunities.



TIME COSTS

The time cost of managing accounts receivable extends beyond that of the AR team. Things like approving credit accounts, managing customer accounts placed on hold, and senior team members' involvement in collections must also be factored into the AR cost. Certainly, it might also be the business owner's responsibility to chase overdue customer accounts in a small business. And, the time spent by senior management on AR management is not only costly; that time would be better spent on revenue-earning activities.



It's likely your accounts receivable is costing you more than you realize. Indeed, when you factor in time, financing, supplies (paper, envelopes, stamps etc..) and opportunity costs, carrying a significant AR balance can be highly costly to a business. However, the accounts receivable cost can be reduced significantly by adopting or updating the company's Credit Policy and leverage technology by adopting electronic invoicing along with an Omni-Channel Payment Acceptance Platform. Every day you knock off your average days sales outstanding the cost of managing AR and reduces the risk of bad debts