High Payment Costs

Situation

Your data has identified an opportunity that contains High Payment Costs, so what do you do next? In many businesses, Payment Costs typically fall in the 1 - 3% of Invoice Price range, and variation in customer specific levels generally creates a drag on margin. Payment Costs have continued to be a source of margin leakage in recent years and generally result from some of the following marketplace conditions:

- Extending the duration of the payment terms
- Poor collections forced by Customers unwilling to pay on time
- Increased discounting for early payments
- Increasing defaults by small businesses
- Fluctuations in Interest rates, affecting the Cost of Capital

Payment Cost leakage generally results from one or both of these conditions:

- Payment Terms have been set too flexibly for one or more customers, such as a small customer receiving 90 day terms.
- Actual Payment history does not adhere to negotiated Payment Terms, such as a customer agrees to 30 day terms but has a Days Sales Outstanding of 57 days.

This paper provides recommendations on how to deal with High Payment Costs.

Recommendations

High Payment Costs can be remedied in the following ways:

- Better Align Payment Terms with Account Goals
- Reduce Payment Costs Through Collections Activity

Better Align Payment Terms with Account Goals

Many companies are under pressure from their customers to increase the length of payment terms. Where possible, this should be governed by Payment Term policies and monitored closely. To take action on our opportunities, we recommend the following:

Condition	Action
Sold-to Customer with High Payment Costs	☐ Understand the Customer’s Classification based on Revenues. ☐ Adjust Payment Terms to match policy or guidance by Customer Class, such as only A or B class customers will be extended Payment Terms beyond 45 days.
Sales Representative, Sales Manager, or Region with High Payment Costs	☐ Monitor the trends and causes of the High Payment Costs within the territory, and ask the following questions: • Does the sales rep fully understand the value of extended terms and sell the value properly? • Is more training or tools necessary for this sales representative? • Should the incentive system include a terms-based component as well as a revenue-based component? ☐ Educate your Sales team on industry practice and Customer Classification guidelines as well as the potential pitfalls of Payment Terms adjustments.

Reduce Payment Costs Through Collections Activity

While members of the Sales teams would not normally be expected to hedge interest rates or deal with collections, there may be ways that the organization can reduce some of the root causes of High Payment Costs.

Condition	Action
Customers Days Sales Outstanding Far Exceeds Their Payment Terms	☐ Look specifically at Customer activity by Class and understand where the slow payers are. ☐ Increase Price or Lower Discount levels for customers who are notoriously slow payers.
High Cost of Goods Sold Due to Processing Costs	☐ Determine if you can you source cash to finance your working capital at a lower rate than the cost to offer the requested payment term to the customer.