Atradius Collections

3 Reasons you shouldn't write off overdue AR early

Credit Management Insights

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Low standards of financial governance are one of the consequences you should take into account.

You've probably taken the measures: monitoring the credit ratings and reputation of your financial counterparties, setting up contractual netting agreements and ISDA agreements, revising the credit limits under certain market circumstances. Yet they don't rule out the possibility that your customers would fail to meet their payment obligations.

Some overdue invoices might be paid after considerable collections efforts from your shared service centre (SSC), global business services (GBS), or business process outsourcing (BPO), whilst some keep riding on your accounts receivable with no end in sight.

When faced with such accounts, you have mainly two options:

- Keep the accounts open on the books until they're collected, or they're proved to be uncollectible
- Write off the accounts

The first option means continuing chasing the overdue invoices, knowing that they inflate your accounts receivable and force days sales outstanding up. The second option means putting an (impermanent) end to the ordeal of collections and keeping your accounts receivable clean.

With the majority of businesses deeming payment collections and handling recalcitrant debtors the most arduous tasks of credit management, it's no surprise that the second option is chosen more often. However, there are hidden catches you might want to consider before deciding to write off every overdue receivable.

1. You lose more than the written off amounts

Once you write off an account, it has a ripple effect on your entire organisation. It's not just the balance that is written off, it's the time of the marketing staff getting the deal, the time of the sales staff closing the deal, the time of the accounting staff recording the account, the time of the SSC, GBS, or BPO chasing the payment, and more.

Next to that, companies overlook the fact that many times, the cost of bad debts exceeds the written off accounts. Its impact is twofold: hurting the bottom line with the loss of the monies you're owed, and restraining the growth of the top line.

For example, you write off four small past due receivables with a total balance of €2,000 and your business has a net profit margin of 5%. To estimate how much your business would need to sell to compensate for the bad debts, divide your net profit margin by your write-offs.

Write-offs / Net profit margin = Additional sales needed to offset the write-offs

In this example, writing off results in your business losing €2,000 and, at the same time, having to make €40,000 more in sales in order to recover from the loss of profit on the €2,000 write-offs.

This is why bad debt expense does not only have to do with the defaulted amount, but it also has a detrimental impact on your cash flow and impedes the profitability of your company.

2. You accumulate credit risk

Usually small accounts receivable are written off because their value does not justify the resources required by the SSC, GBS, or BPO to collect them. However, their volume is often so substantial that the cumulated balance could exert mounting pressure on your working capital. Given that no business is immune to bad debt, the strain keeps increasing as time goes on. The risk is notably high in emerging markets, where multinationals typically establish local operating subsidiaries.

Nonetheless, most don't realise what is at stake since it's common for written-off accounts to fade into oblivion – out of sight, out of mind. When they aren't open on the ageing, there is little incentive for the SSC, GBS, or BPO to assess the situation or to seek alternative collections solutions. What you may end up doing is practically granting the customers financing for free.

It should also be taken into account that behind every written off balance is a decision to extend credit. By leaving the overdue accounts on the accounts receivable, it's apparent that the rest of the ageing could make more use of risk mitigation measures. Without a commitment to reduce write-offs, the credit risk lurking in everyone's blind spot is likely to develop to be far greater than expected when it materialises.

3. You deviate from good stewardship of accounts receivable

Many write-offs equal a large amount of bad debt expense, which would eventually show up on financial statements and come under close scrutiny. To soften the blow, only parts of the write-offs make their way to the reports in most cases. Considering that bad debt expense is probably the most important non-cash expense in a financial report, the lack of congruity can produce two adverse effects.

The immediate effect is misstatements in reporting due to the accounts receivable being exaggerated. The knock-on effect is an increase in write-offs including accounts that could still be collected – for it's an easier option and there are no consequences of writing off frequently in the first place.

As a result, writing off becomes the preferred choice by the SSC, GBS, or BPO whenever the circumstances allow it. This raises the written-off balances, which wouldn't be fully presented in financial reporting because of their large number. In this way, the vicious circle repeats itself.

Such outcomes could prove seriously damaging, especially to multinationals where it's possible for more than one local operating entity to abandon effective financial controls and governance.

The perception of 'write off and move on' certainly doesn't hold true when you look at the full impact it could have on your organisation. Although write-offs can't be avoided entirely, all means should be exhausted before any overdue accounts receivable are judged as uncollectible. Methods like ageing analysis and persistently tracking each unpaid invoice can prevent overdue receivables from slipping through.

If the customers keep being unresponsive to your collections attempts, it may be time to seek support from a third-party specialist. There are some advantages they can supplement your SSC, GBS, or BPO with.

The most important gain is your time and resources. Once an external collections specialist takes over the ageing accounts, you can channel your team's attention into the new and current receivables.

Next to that, your chance of collections improves significantly. Major collections agencies often bring years of experience and specialised approaches to the table. Combined with your knowledge of the customers, collections approaches from a third party carry much more weight in many cases; because the customers interpret a third party's involvement as your escalation of the matter.

Another benefit is that your financial reporting is improved. Good collections agencies always document their collections efforts and interactions with the debtors. The information does not only add more details to your reports, but also helps maintain reporting standards across all your local operating subsidiaries.

Last but not least, your compliance is guaranteed. International collections agencies like Atradius Collections have an extended network of local law firms that ensure every collections activity complies with the regulations of the country where it's performed.

Compared to writing off, making extra collections endeavours to recover overdue accounts receivable might seem less enticing. Yet, both the workload and resources required for this are commonly found to be below what it takes to compensate for the writing off of the same balances. At the same time, by taking measures to mitigate writing off and save it as the last resort only, you've minimised its risks and saved both the top and bottom line of your organisation.

Would you want more recoveries and fewer write-offs?

Our Atradius Collections teams around the world have decades of experience in helping multinationals successfully manage and collect their accounts receivable.

We could support your SSC, GBS, or BPO in:

- Collecting your outstanding accounts receivable amicably (third-party collections)
- Managing part of or your entire accounts receivable portfolio (accounts receivable outsourcing)
- Covering other aspects of your collections and accounts receivable management

Please contact us to discuss ways we can help improve your accounts receivable.

Contact us

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