



Figuring Accounts Receivable Carrying Costs

Does your selling price include the cost of carrying the accounts receivable? Where is your cash currently tied up? Look at your total uncollected sales and A/R. Imagine it as a large lake in which huge amounts of cash can be trapped. The longer the cash sits there, the harder it is to collect and the more it costs you (see chart at right). The faster you can collect your A/R, the better the impact on your bottom line.

Loss:

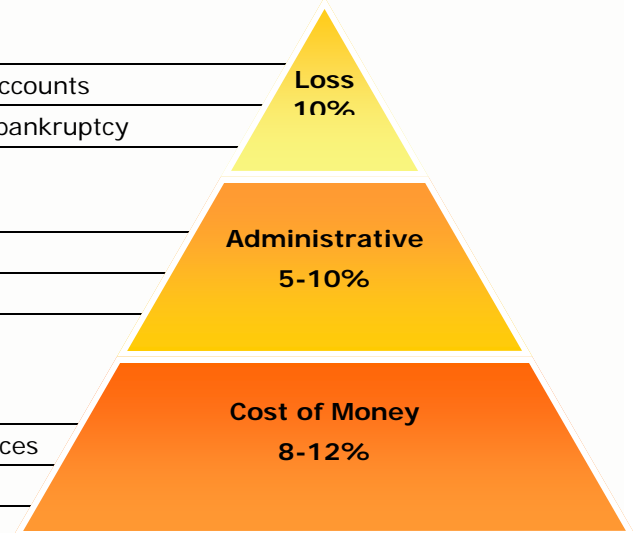
- Disputed accounts
- Customer bankruptcy

Administrative:

- Bad debt insurance
- Collection expenses

Cost of Money:

- Interest rate for financed resources
- Opportunity loss



Cost of Carrying A/R Pyramid

WONDERMENT® Project Steps:

Fill out the following table for one of your accounts receivable:

	Account Example	Company Example	Your Company
Average collection time	180	60 days	
Industry average collection time	30	30 days	
Excess AR days	150	30 days	
1 day sales (annual sales/365)	--	\$ 15,000	
Cash invested in excess AR	\$5,000	\$ 450,000	
Annual interest cost (@ 5%)	--	\$ 22,500	
Annual AR carrying cost (@ 25%)	\$625	\$ 112,500	

Example: Motor Company

Douglas' Motor Company had a \$5,000 account that was 180 days old. The cost of carrying the A/R was determined to be 25% annually. After applying the A/R costs, the \$5,000 was reduced by \$625.00. DMC worked on a 20% markup, and 62.5% of the profit was lost.

What questions does this raise?

Regarding your collection strategy...

- Can you afford an extra 10-12% of costs?
- Can you expedite the processing of receipts and accelerate the collection of funds?
- Does it make good business sense to offer a trade discount and/or a penalty for late accounts?

If you have questions or comments please contact us. Log on to www.jacquard.com or call us at 847.945.8700.