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Customer selection assumes a new significance in a recession

Companies are facing many new challenges figuring out how to do business in this recession. One of the critical areas is selecting customers.

Few businesses today are not struggling to retain customers and achieve revenue targets. With reduced revenue comes an emphasis on expense reduction. But expenses can only be reduced so much until the core of an organization is put at risk. Where costs have been reduced to the extent practical, the focus shifts back to revenue maintenance and growth.

The question is this: "How do we expand our customer base and increase revenue in a recessionary economy without taking unreasonable risk?"

In considering customer selection in this challenging new environment, consider the following steps.

Assess core vs. outlier customers.

In evaluating any customer opportunity, whether existing or prospective, the initial inquiry is to determine whether a particular customer is a core customer or an outlier.

A core customer is one that meets most if not all of the key criteria of a model customer. The factors are particular to each business and can include such things as industry, number of employees, annual revenue, annual sales or billings to the customer, payment history and where the customer does business.

Most importantly, a core customer is one where management has no doubt it can meet the requirements of the customer and make money in the process.

An outlier is a customer that meets some

but not all of the factors, and where taking the business requires some amount of compromise. There may be concern in terms of ability to perform profitably or even at all. Focus on the core.

Conduct a credit underwriting.

In the current economy, it is imperative that management underwrite the ability of customers to pay. Review relevant financial information, including balance sheets and income statements and statements of cash flow. Unless sales are made against bank drafts or letters of credit, the company is providing financing and extending credit to its customers. If a customer is unwilling to provide sufficient information on which to make a reasonable judgment regarding its ability to pay, that's a clear message for management to move on.

Require written agreements with deposits.

Any customer relationship that includes credit extension should be evidenced by a written agreement setting out the essential terms of the relationship, including delivery, payment and default remedies. The agreement should provide that interest will be charged for past-due payments. The agreement should be entered into before the products are manufactured or delivered or the services are rendered. The agreement should also require a deposit — something that, particularly in the professional services world, is not often rigidly enforced.

The practice of extending credit without a deposit is one that should be reconsidered now. Smart managers are covering payment risk whenever possible, and requiring deposits is smart business.

Require shortened payment terms.

In robust economic times, many companies relax their collection policies and give their customers leeway.

In a recession, customers will typically manage cash as conservatively as their suppliers will allow and delay payments, while at the same time suppliers place a premium on accelerating cash collections from customers. This tension between suppliers and customers can be very uncomfortable, but nevertheless must be addressed.

If the typical payment cycle is 45 days, consider reducing it to 30; if 30, consider reducing it to 15. And, for professional service firms that often rejoice in victory when invoices are paid within 60 days, focus on reducing the payment cycle to 30 to 45 days. Keep in mind that obligations that extend beyond 90 days are much less likely to be paid.

Implement focused client account management.

The last step to managing customer selection risk is to develop an account management process. This should incorporate a disciplined account management strategy, a means to identify early where there are problems and an aligned approach to handling delinquent customers.

Stay close to your customer. Good process, early indications of problems and disciplined practices to deal with those problems can potentially reduce risk, increase collections and actually improve the customer relationships.

The keys to maintaining and growing revenue today without taking unnecessary risk are to focus on core customers, conduct appropriate credit underwriting, document the relationship and get a deposit, manage the relationship consistent with the contract and implement effective collection and customer relationship policies. Companies that follow these steps are much more likely to succeed in this difficult environment than those that chose to rely on past practices.

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