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Accounts Receivable Management at Local Cooperatives: A Review of Actual Practices and Strategies for improvement

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ACCOUNTS RECEIVABLE MANAGEMENT AT LOCAL COOPERATIVES: A REVIEW OF ACTUAL PRACTICES AND STRATEGIES FOR IMPROVEMENT*

by

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*Steve Blank and Larry Janssen provided useful comments on this paper, but the authors are solely responsible for any remaining ommissions or errors.

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SUMMARY OF

ACCOUNTS RECEIVABLE MANAGEMENT AT LOCAL COOPERATIVES: A REVIEW OF ACTUAL PRACTICES AND STRATEGIES FOR IMPROVEMENT

Brian H. Schmiesing and Julie A. Bleyhl

1. A credit policy should reflect the cooperative's basic philosophy of credit and how credit relates to organizational goals. The credit policy should define the credit relationship for management, employees, member-patrons, and board of directors (pages 2-4).

2. Eighty-two percent of the cooperatives had a written credit policy but the written credit policies received by the researchers varied widely in terms of quality and detail (pages 5-7).

3. Sixty-eight percent of the cooperatives deviated from their written credit policy. The most frequent reasons given were implementation of a new credit policy, agreement with creditor, and special treatment of larger customers. If a cooperative is having difficulties maintaining its market share, the problem should not be buried in a poorly administered credit policy (page 8).

4. Only 52 percent of the cooperatives required credit applications of a new credit customer. However, the majority of those cooperatives requiring credit applications did establish credit limits, required a completed application before extending credit and did complete the credit evaluation before extending credit (pages 9-10).

5. A major problem area appears to be in credit evaluation. Only six of 74 cooperatives had a formal credit evaluation form. If regional cooperatives and educators are going to recommend the collection of information, they must provide training on how to use the information (page 8).

6. The timing of credit procedures varied significantly among the cooperatives surveyed. Cash on delivery was within 60 days of sale for the majority of the cooperatives. Collection agencies were used within 180 days and farm visits within 90 days by the majority of the cooperatives. The majority wrote off their bad debts in 365 days of sale (page 11-13).

7. Cash discounts were used by 69 percent of the cooperatives. The most frequently appearing discount was 2 percent. Cooperatives using higher discounts may want to evaluate their current discount strategy (pages 14-16).

8. The majority of the cooperatives did their billing between the first and tenth of the month. Cooperatives may want to examine their billing dates to improve cash flow and its relationship to credit terms (pages 17-19).

9. Sixty-nine percent of local cooperatives were using an on-line computer service or had a computer on location. A very wide range of computer hardware is being used by local cooperatives. Cooperatives not having

a computerized system may want to examine the advantages and disadvantages of such systems.

10. Eighty-two percent of the boards of directors are reviewing the aging of the accounts receivable on a monthly basis. Of those boards of directors reviewing the accounts receivable, a wide range existed in the amount of detail provided (pages 20-21).

11. Twelve cooperatives or sixteen percent of the survey cooperatives had boards involved in the collection of accounts. This practice has considerable potential for disrupting a cooperatives credit program and should be avoided if at all possible. Collections are management's job (pages 22-23).

12. Board members were allowed to have credit accounts in 90 percent of the cooperatives. The majority of the cooperatives did not require credit applications of board members (pages 22-23).

13. Eight cooperatives did not let employees have a credit account, but a lack of credit evaluation of employees was evident in a number of cooperatives. Sixty-four percent of the surveyed cooperatives indicated that they had had an employee become overdue on their credit account during the past three years. Cooperatives should have a concise and clear credit policy concerning employees (pages 24-25).

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ACCOUNTS RECEIVABLE MANAGEMENT AT LOCAL COOPERATIVES: A REVIEW OF ACTUAL PRACTICES AND STRATEGIES FOR IMPROVEMENT

Brian H. Schmiesing and Julie A. Bleyhl[a/]

Accounts receivable represent a major operating expense for local cooperatives. For example, the average local Minnesota cooperative affiliated with a major regional cooperative in 1983 had 35 percent of their total current assets being accounts receivable and credit costs associated with accounts receivable represented 2.5 percent of the credit sales revenue. In contrast, local net savings were only 1.2 percent of sales. Effective accounts receivable management is particularly important in a period of financial stress in agriculture, high interest rates on borrowed capital and narrow local cooperative margins.

This paper will review the actual accounts receivable management practices of local cooperatives in southwest Minnesota, eastern South Dakota and northwest Iowa in 1983. These practices will be reviewed relative to standard industry recommendations concerning accounts receivable management strategies. The paper will also provide ideas and suggestions that local cooperatives may consider in their efforts to implement successful accounts receivable management programs.

Background of Survey Used in the Study

The local cooperative survey was conducted in early November 1982. Local cooperative managers within a 100 mile radius of Marshall, Minnesota received questionnaires. During the first week in December a second questionnaire was sent to managers who had not responded to the survey. This represented a 30% response rate for the survey. Along with the questionnaire, the managers were requested to return a copy of the cooperative's credit policy and their 1982 annual statement.

What Is a Good Credit Policy?

A credit policy should be more than the terms of credit between the cooperative and its member-patrons. Rather the cooperative's credit policy should communicate to the member-patrons, employees, management and board of directors, the cooperative's philosophy and objectives concerning convenience credit at the local cooperative. A credit policy approved by the board of directors provides an effective control mechanism in the accounts receivable management programs of local cooperatives. What are the characteristics of a good credit policy?

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Credit policies are primarily statements of intent or promises about the cooperative's philosophy concerning the vital issues associated with convenience credit at the cooperative. A central feature of "good" policy is that it is a "promise" not a "threat." The only creditable "threat" is a "promise." Policies approved should be policies that the board of directors are willing to enforce.

A credit policy does not have to be a long and detailed document. The basic characteristics of a good credit policy include the following:

A. The policy is in writing.
B. The policy is broadly stated.
C. The policy is long run and long term.
D. The policy is not to be violated.
E. The policy should be adopted by the board of directors.

Figure 1 contains an example of a credit policy that addresses many of the vital issues associated with convenience credit at a local cooperative. Although the policy is only one page long, the policy provides a clear message to management concerning the board of director's expectations about the credit program to be implemented at the local cooperative. In the same manner, the board has an explicit definition of its role and philosophy.

A credit policy should address the role of credit relative to the cooperative's organizational objectives and the basic philosophy of credit concerning member-patrons, board members, management and employees. For example, the sample credit policy clearly indicates that the extension of credit should not adversely affect the net savings or net worth of the cooperative. Also, the cooperative will not be a long term lender for a member-patron and credit will be used to maintain the cooperative's market share. These statements give definite indications of how credit relates to the cooperative's objectives.

Local cooperatives have four basic groups that become involved with the cooperative's convenience credit: member-patrons, management, employees, and boards of directors. The credit policy should define the cooperative's philosophy of credit for its relationship with each of the groups involved with the cooperative. In the sample credit policy the board has indicated to management that overdue accounts of employees will not be tolerated and will be used as a basis for firing (dismissal).

The reader will note that specific details are kept to the minimum in the credit policy. The policy does not indicate what specific financial information the board wants at its monthly meeting. Also, the credit policy does not indicate specific methods for the determination of the profitability of a specific credit sale. Management has the responsibilities for the design and implementation of a specific credit program to accomplish goals of the credit policy. By avoiding excessive detail, the board of directors and management can establish a credit policy that provides a long term guide to the credit program. A credit policy should not require constant revision. Another advantage of such a policy is that new management can readily identify what the board desires in the cooperative's credit program.

Figure 1: A Sample Credit Policy for a Local Cooperative

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1. The extension of credit will be provided as service to cooperative members. The availability of credit is a priviledge, not a membership right.

2. The cooperative's credit policy will enable the cooperative to maintain or expand its market share within its trade area.

3. Each month the general manager will supply timely information on the credit accounts and plans to the board of directors.

4. The credit policies will be applied to all members to insure equitable treatment of members.

5. All credit accounts held by management and employees will be current. Abuse of the credit priviledge by management or employees will result in dismissal.

6. Permanent financing of members through extended credit terms shall not be undertaken. The cooperative will assist members in their efforts to obtain such permanent financing.

7. The extension of credit will be based on product profitability relative to the risk of the sale.

8. Bad debt losses and the extension of credit will be maintained at a level equitable to all members.

9. Management will establish procedures for the evaluation and collection of credit accounts consistent with the protection of the cooperative's net savings and net worth.

10. Member contacts concerning credit will be timely, firm, tactful and consistent with the credit policy.

11. Management will present a credit program to the board of directors for approval.

12. Cooperative members will be informed of the credit policy and credit terms of the cooperative.

How Does a Credit Policy Relate to a Credit Program?

A credit program should explain the specific activities that cooperative employees will undertake to achieve the credit policy's objectives. This credit program should be approved by the board of directors and should be more specific than the credit policy. Presented in Figure 2 are the basic components of a credit program and its relationship to the credit policy (4,5).

A flow chart of specific actions is a good method for summarizing the actions to be taken and the timelines in the credit collection process. The flow chart indicates that credit applications and their evaluation come before the actual credit sale. Specific timelines are indicated for specific components. More detail should be contained in the credit program components. For management of delinquent accounts, timelines could be established for when the first on-farm visit would occur or when the account would be turned over to a collection agency.

A cooperative's credit program must be designed to meet the specific conditions of the local cooperative and the economic conditions in its specific markets. If a cooperative has a very small percentage of their total assets being net worth, the cooperative will want an aggressive credit program to minimize the amount of time funds are loaned to producers and the risk contained in its accounts. A financially strong cooperative has the ability to absorb more risk and may be able to justify a more liberal credit policy. Also, credit programs must adapt to changing economic conditions. A liberal credit policy may be more feasible during profitable periods in agriculture than in unprofitable periods. For corporations to have an effective credit program they must anticipate changes that will affect their credit program's effectiveness.

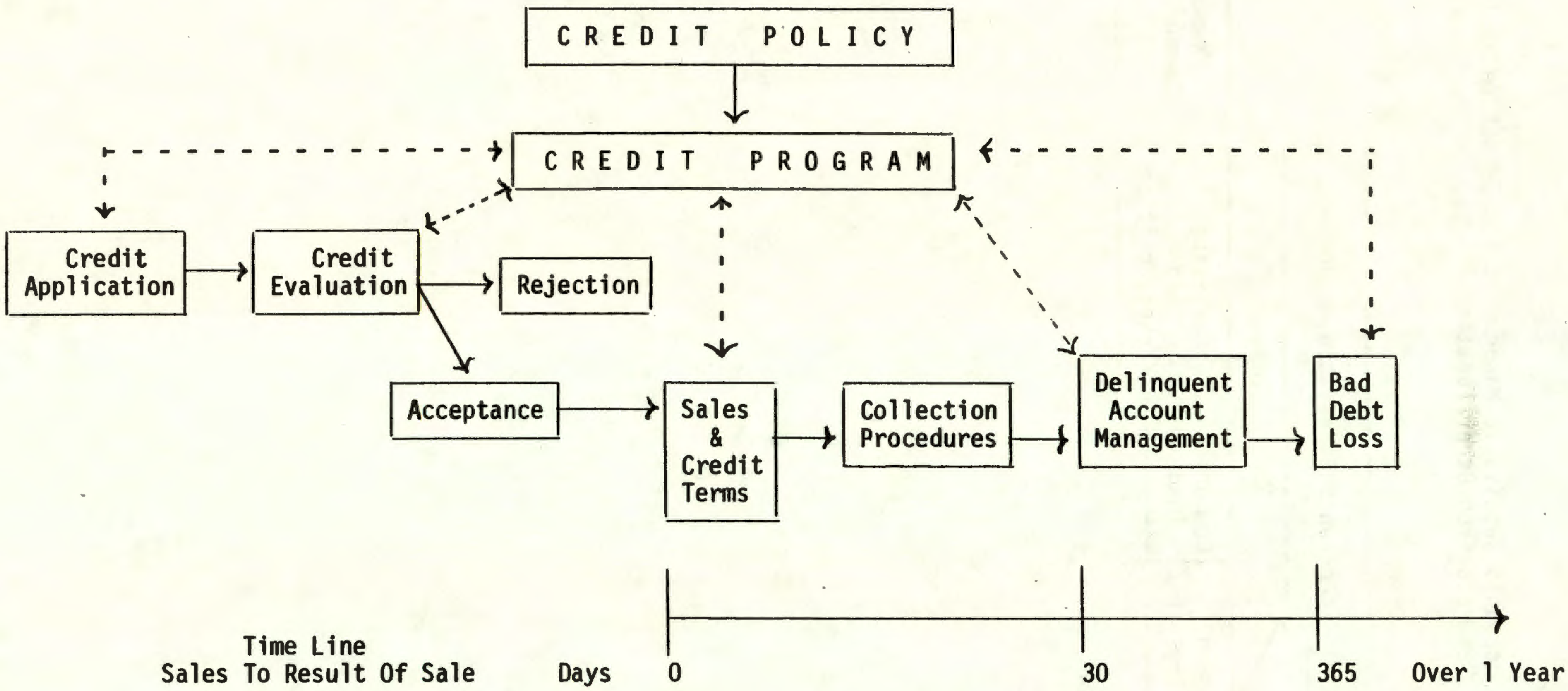
A major point to remember is that credit programs have a major impact on a broad range of business areas within the cooperative (see Figure 3). Problems in credit collection may be symptoms of problems in other areas of the business. Poor billing procedures, overselling of products, lack of quality control in products sold, lack of an employee orientation program and lack of member communications are just a few examples of problem areas. Changing the credit terms will not solve the problem if the poor performance of the credit program is caused by other problems within the cooperative. Before changing credit terms the board of directors and management must closely evaluate the key performance areas that may adversely affect the credit program.

Let us examine the results of the cooperative survey concerning the credit policies and credit terms of the local cooperatives. The following discussion will first discuss the timing of credit program activities in a manner similar to the flow chart presented in Figure 3. First we will examine the existence of credit policies in local cooperatives.

Existence of Credit Policies at Local Cooperatives

The survey found that the majority of the managers indicated that their local cooperative had a written credit policy (see Table 1). The managers were requested to supply a copy of the credit policy if they had written policies. The diversity in the quality and detail of the written credit policies were extremely wide, ranging from a simple statement of the credit

Figure 2: Relationship Between Credit Policy and Credit Program



Source: Fassler, Michael L. and Burghardt, William G. "Credit Management for Agricultural Cooperatives: Techniques for Trade Credit Analysis and Planning (Part 1)." The Cooperative Accountant. Vol. XXXVI, No. 3 (Fall, 1983): 26-40.

Figure 3: Accounts Receivable Management Should Not Be An Issue Separate From Other Functional Areas In The Business.

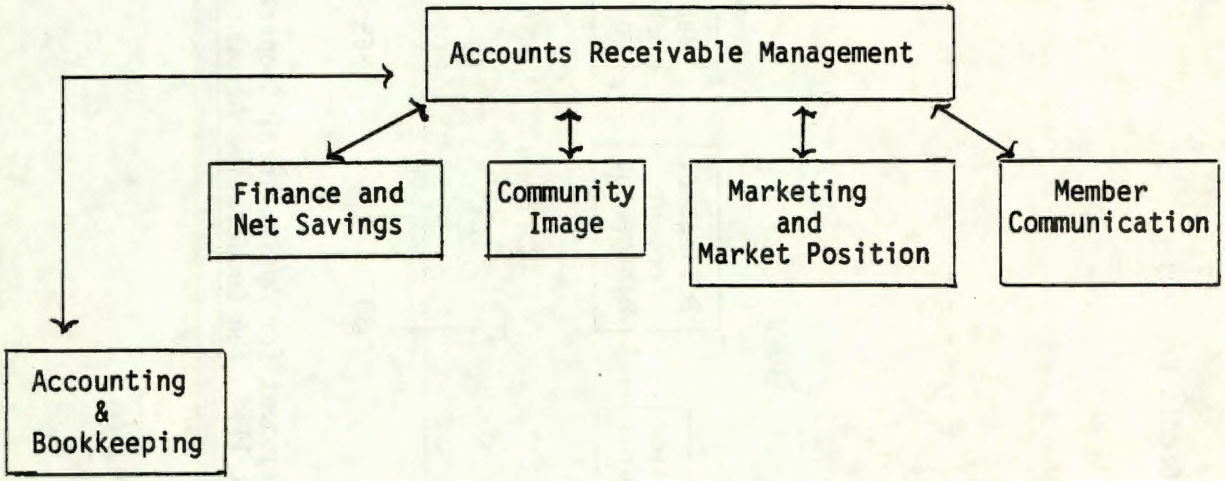


Table 1: The Number of Local Cooperatives Having a Written Credit Policy and the Use of the Credit Application in the Credit Program.

Description	Number of Cooperatives	Percentage of Total
1. DID THE COOPERATIVE HAVE A WRITTEN CREDIT POLICY?		
a. Yes	61	82%
b. No	10	14%
c. Missing Data	3	4%
d. Total	74	100%
2. DID THE COOPERATIVE DEVIATE FROM THEIR CREDIT POLICY?		
a. Yes	50	68%
b. No	18	25%
c. Missing Data or Not Applicable	6	7%
d. Total	74	100%

terms to a fairly detailed description of the philosophy concerning the availability of credit to members, credit terms and a description of the collection procedures used by the cooperative. Appendix I contains a sample member-patrons credit policy statement. Hopefully, the example can provide the reader an idea of how such customer credit policy can be used as a communication tool to a member-patron. These customer credit policies are not the same as the broader credit policy that should be approved by the board of directors.

Cooperatives Do Deviate from Their Policies

Although the majority had a written credit policy, sixty-eight percent indicated that they had deviated from their credit policy. The most frequent reasons given for deviating from the credit policy were the need to train members concerning new credit terms, a good customer overlooks a bill and forgets to pay, special treatment to large customers, an agreement with a creditor or need to retain business. Management and the board of directors must be careful that the deviations do not become an informal policy. Member-patrons will use the cooperative's capital if they find this to be possible (see Table 1).

In the area of deviations of policies, the special treatment of large producers is particularly dangerous. Large credit accounts have the greatest potential to do serious damage to a local cooperative if the customer should default. Preferential treatment which becomes public information may cause considerable damage in member relations not only among smaller member-patrons but also among larger patrons, who did not receive the treatment. If the cooperative offers a cash discount for early payment, an efficient farm manager will take advantage of such discounts. A manager must know the costs of carrying the account. The implicit price concessions may actually make the sale unprofitable.

If the cooperative is having difficulties retaining its larger customers or has other competitive problems, this issue must be addressed and not buried within a poor credit program. Pricing strategies and other marketing strategies should be evaluated. Deviations from policies only insure abuse and increased risk exposure to bad debt losses.

A major method for controlling the risk exposure is to evaluate the quality of credit represented by an account. This is the use of a credit application for convenience credit at the cooperative and the analysis of the information contained on such an application form.

Use of Credit Applications for New Customers

Although credit applications are widely recommended, only 52 percent of the cooperatives surveyed required credit applications from new credit customers. A critical aspect of credit management is the evaluation of credit risk. If a cooperative does not have information on its customers, how can the cooperative properly evaluate the credit risk associated with a new account?

However, those cooperatives having credit applications do appear to be using the credit information in their determination of the amount of credit extended to a customer. Seventy-nine percent of the cooperatives using credit applications for new customers used the credit application to determine the maximum amount of credit they would extend to the new customer. The same percentage of those cooperatives also indicated that they did not allow customers to charge on their credit account until they had completed the credit review (see Table 2).

A major question is why cooperatives do not use credit applications more extensively. A partial answer to this question lies in the response the researchers received concerning an inquiry into whether the local cooperatives were using credit grading forms to evaluate their customers. Only six of the 74 cooperatives had a formal form for evaluating their customers. If cooperative management lacks training on credit evaluation and credit information, their perception concerning the limited value of credit applications may be justified. If regional cooperatives and educators are going to advocate collection of information they have the responsibility to educate local cooperatives on the effective use of the information.

Hidden Value of Credit Applications and Credit Evaluation Forms

Credit applications and credit evaluation forms have the potential for becoming a very powerful management tool. The reason is the increasing availability of micro and minicomputers at local cooperatives. The availability of computers will enable local cooperatives to do more indepth analysis of their customer base. Maintaining up-to-date credit information on customers may provide valuable information on their customer base and marketing efforts. Is the member-patron's business growing faster than his business with your cooperative? Are your member-patrons changing the mix of commodities they are growing? What is the financial condition of member-patrons? All of these factors impact on how a cooperative should market its products and services to its member-patrons.

In Appendix II are sample credit applications and on Table 3 an evaluation form. Collection agencies and regional cooperatives can provide local cooperative assistance in the development of credit program and samples of additional forms to use.

Given the lack of use of credit evaluation forms let us look more in detail at the credit evaluation. The weightings of the evaluation can be established by the cooperative's credit manager. The four "C's" of credit should be contained in the evaluation. Does the farm have sufficient capital for its operation and does the farm have the liquidity to pay its accounts? Does the farmer have a reputation for being honest and paying his/her bills? What is the outlook in the farmer's industry and what is the expected return on investment? Does the farmer have the management, reserve capital and earnings potential to weather adverse conditions? The weighting scheme should be based on what management feels to be most important. A farm supply business is different from a long-term lender. The ability to meet short term obligations is the primary concern of the farm supply business, i.e. liquidity and available security. A long-term lender must take a longer term viewpoint of the operation.

Table 2: The Number of Cooperatives Requiring a Credit Application From New Credit Customers and the Use of the Credit Application in the Credit Program.

Description	Number of Cooperatives	Percentage of Total
1. WERE CREDIT APPLICATIONS REQUIRED BY THE COOPERATIVE FOR NEW CREDIT CUSTOMERS?		
a. Yes	39	52%
b. No	31	42%
c. Missing Data	4	6%
d. Total	74	100%
A. DID THE COOPERATIVE ESTABLISH CREDIT LIMITS AT DIFFERENT LEVELS FOR CUSTOMERS BASED ON THEIR CREDIT WORTHINESS?[a]		
a. Yes	31	79%
b. No	7	18%
c. Missing Data	1	3%
d. Total	39	100%
B. DID THE COOPERATIVE REQUIRE A COMPLETED CREDIT APPLICATION BEFORE EXTENDING ANY CREDIT?[a]		
a. Yes	31	79%
b. No	6	16%
c. Missing Data	2	5%
d. Total	39	100%
C. DID THE COOPERATIVE COMPLETE A CREDIT EVALUATION BEFORE EXTENDING ANY CREDIT?[a]		
a. Yes	31	79%
b. No	6	16%
c. Missing Data	2	5%
d. Total	39	100%
2. DID THE COOPERATIVE USE A GRADING FORM TO EVALUATE THE CREDIT CUSTOMER?		
a. Yes	6	8%
b. No	64	87%
c. Missing Data or Not Applicable	4	5%
d. Total	74	100%

[a] These were the responses only for those cooperatives that required credit applications for new credit customers.

Table 3: A Sample Credit Evaluation Form or Risk Analysis Chart

Description of Credit Factor		Best	Good	Average	Poor	Bad
CAPITAL:						
1.	Current Ratio	5	4	3	2	1
2.	$\frac{\text{(Current Assets - Inventories)}}{\text{(Current Liabilities)}}$	5	4	3	2	1
3.	Total Debt to Total Asset Ratio	5	4	3	2	1
CHARACTER:						
4.	Reputation of Firm in Business Dealings	5	4	3	2	1
5.	Past Payment Record	5	4	3	2	1
CONDITION:						
6.	Anticipated Return on Investment	5	4	3	2	1
7.	Industry Outlook of Producer's Primary Business	5	4	3	2	1
CAPACITY:						
8.	Experience and Quality of Management	5	4	3	2	1
9.	Financial Trends (3 Years)	5	4	3	2	1
10.	Security or Line of Credit Available	5	4	3	2	1
Total Score	____	=	+	+	+	+

Comments:

Four basic advantages in using credit evalution forms are the following:

1. The manager must evaluate the member-patron based on a systematic method.

2. The manager has a record of his credit evaluations, which he/she can use to improve his/her evaluations of credit decisions.

3. When the manager updates the credit application for the cooperative's accounts, the manager will be familiar with the actual situation of the account not a historical perception.

4. If the computer system allows the linkage, management can link the credit ratings to the aging of accounts receivable. The management then has the ability to judge the potential risks and the ability to collect the accounts receivable.

The major reason for up-dating credit evaluations and credit information is to insure management knows their customer's credit conditions. Past history is not enough. The classic example is the farmer, who is helping his son to start farming. The older farmer has always been a solid account, but the son expands his operation with too much debt. Suddenly the son's operation is in major difficulty and the lender wants his money. The father co-signed the note so his operation also is now in trouble. Basing a credit decision on only past information is risky, drastic changes in the financial health of a farmer can happen rapidly.

Why the Need for More Analysis

Agribusiness margins have narrowed. A much larger volume of sales is required to offset bad debt losses or other costs associated with poor credit accounts. This need for larger volume of sales is at the very time when sales are stagnating or actually decreasing.

The need for credit evaluation before the sale is essential. The trite saying that "a sale is not a sale until the money is collected" is all too true. What about the collection processes used by cooperatives in the survey?

Collection Procedures

After a credit sale, a cooperative within its credit program has a number of options to obtain payment on overdue credit accounts. The initial step is prohibit any more credit sales to the customer or putting the customer on a cash on delivery basis. The credit program must pay particular attention to timeliness, insistence, persistence and communication. To measure the level of these factors at local cooperatives, the survey inquired into when cooperatives undertook specific credit program activities.

Because slow collections require the cooperative to borrow more money and greater bad debt losses can be expected, the lack of a timely credit program can adversely affect earnings. The majority of cooperatives place member-patrons on cash on delivery basis within 60 days of the sale if the account is overdue.

This type of action insures the cooperative limits its losses (see Table 4). Cooperatives instituting cash on delivery requirement more than 60 days after the sale may want to examine this aspect of their credit program. For example, The Fertilizer Institute's Agribusiness Credit Managers Handbook recommends that the customer be put on cash on delivery within a specific time period of when the account becomes overdue (3, pp. 8).

Another collection action is a farm visit by a cooperative representative. Eight-five percent of the cooperatives used this in their collection activities. The majority did this within 90 days of the sale. Such a collection activity must consider the current size, the potential growth and financial risk of the account. A farm visit may be justified for a $28,000 fertilizer bill but not a $100 fuel oil bill. The bottom line is that collection procedures must make economic sense. Based on your credit evaluation, you know the risk of the account and the need for quick action should not be discounted.

Eighty-one percent or 60 of the cooperatives used collection agencies in their collection process. When did this third party enter into the collection process? Less agreement was apparent among the cooperatives on when collection agencies should enter into the collection process. However, the majority did have a credit agency become involved within 180 days of the sale. The older the overdue account, the less money collected per dollar of sales. If a debt is past due by 6 months the average collection is 67 cents per $1.00, while if a debt is overdue for a year only 45 cents is collected (3, p. 39). Swift action by a number of cooperatives was indicated with 42 percent using a credit agency within 120 days.

The use of a credit agency must in part be based on the success of in-house collection activities. Evaluations must be made on which is the most profitable once the account becomes overdue.

The final activity is the writing-off of bad debt losses. The most prevalent was to write off the debts within one year. Writing-off bad debts in two years results in the cooperative overstating its assets and earnings. This practice gives a false impression of the availability of earnings and financial strength of the balance sheet. If the cooperative is highly leveraged, this type of error may have serious implications if it results in the board of directors and management not taking appropriate action.

This problem is even more serious if the accounting system includes the finance charges as part of earnings for the cooperative. If no one is going to collect the outstanding principal, it is unreasonable to expect the collection of the interest charges. A recent case existed in a local cooperative, where this type of error resulted in an overestimation of earnings by tens of thousands of dollars.

Methods for Encouraging Member-Patrons to Pay

One of the principal methods for encouraging members to pay early is the use of cash discounts. The impact of a properly designed cash discount is to increase the priority of paying the local cooperative before other outstanding debts. The cash discount period, the net due date, the financial charge, cash

Table 4: The Number of Days after the Sale that Is Required Before Specified Credit Program Actions are Undertaken

Number of Days	Cash on Delivery for Purchases		Collection Agency Used to Collect		Farm Visit Done by the Cooperative		When Bad Debts Are Written Off by the Cooperative	
	Number	Percent	Number	Percent	Number	Percent	Number	Percent
0-30	4	5%	0	0%	3	4%	0	0%
31-60	37	50%	2	3%	20	27%	0	0%
61-90	19	26%	14	19%	19	26%	0	0%
91-120	1	1%	14	19%	6	8%	0	0%
121-150	0	0%	1	1%	2	3%	0	0%
151-180	2	3%	12	16%	5	7%	4	5%
181-210	0	0%	1	1%	0	0%	0	0%
211-240	0	0%	1	1%	0	0%	0	0%
241-270	0	0%	0	0%	0	0%	1	1%
271-300	0	0%	0	0%	0	0%	0	0%
301-330	0	0%	0	0%	0	0%	0	0%
331-365	0	0%	5	7%	0	0%	44	59%
366-730	0	0%	1	1%	0	0%	8	11%
N.A. or Missing Data	11	15%	23	32%	18	24%	17	23%
Total	74	100%	74	100%	74	100%	74	100%

discount offered and billing practices all impact on the effectiveness of the cash discount in increasing the priority of the cooperative's bill (1, 2, 6, 7).

For example, consider a cooperative that bills its customers at the time of sale and credit terms are based on the date of sale. The cooperative offers a 2 percent discount due in 10 days after the sale. Let us vary the number of days from the sale that the cooperative requires the net due from a range of 30 to 90 days. If the producer does not take advantage of the discount, he/she will have to pay a higher price. This higher price can be perceived as being an interest charge on the number of days between the last day of the discount period and the net due date (see Table 5).

If a cash discount is to be effective, the cooperative must design credit terms that encourage producers to pay. In the example, we see that credit terms, that provide producers a large number of days between the last date of the discount and net due date, provide the producer little incentive to pay early. If producers are paying 15 percent interest rates on borrowed capital, they have little incentive to pay the cooperative when the number of days exceeds 50. Cooperatives should communicate to their members the implications of using the cash discount.

A majority of the cooperatives did use cash discounts, but not all these cooperatives used percentage discounts. A number of the cooperatives used absolute cash discounts like 1 cent per gallon of gas discount. Others used a combination of both, depending upon the margins in the product being marketed. The establishment of a cash discount must take in consideration the competition, but also be designed to insure the cash discount relates to the specific goals of the cooperative. The most frequently occuring percentage discount was two percent. Cooperatives with higher percentage discounts should examine carefully the costs of their discounts and its relationship to their pricing strategies. By altering the credit terms, they may be able to achieve their credit objectives at a lower cost (see Table 6).

THE CREDIT TERMS AND BILLINGS

The method of billing and the terms of credit must be consistent. If credit terms are based on the date of sale, the cooperative must be sure to promptly bill the member-patron. If the member-patron is going to take advantage of cash discounts, s/he must receive a proper billing quickly. Again, the computer can provide assistance in speeding up the billing process.

Cooperatives usually base their credit terms on three basic types of dates. The credit terms can be based on the day of sale, the date when the customer is billed or a specific day during the month. Credit terms based on day of sale, such as the cash discount, will insure the cooperative receives payment as quickly as possible. There is no advantage for patron to postpone a purchase so that s/he will be billed the next month. With credit terms based on the monthly billing or a specific date during the month, the producer has an opportunity to plan for and expect the bill. The due date for the credit is well known. This is not the case with credit terms based on date of sale, plus there may be additional costs in the billing of customers.

Table 5: Annual Interest Rate Charged to the Producer for Not Taking Advantage of Cash Discount When the Net Due Date Ranges Between 30 Days and 90 Days

Credit Variable	Number of Days Before Net Balance Is Due: 30 Days	60 Days	90 Days
1. Principal	$1,000	$1,000	$1,000
2. Cash Discount Percentage	* .02	* .02	* .02
3. Interest Charge for Not Using the Cash Discount	$ 20	$ 20	$ 20
4. Difference Between the Net Due Date and Discount Days	20	50	80
5. Annualized Interest Rate Charged if Discount Not Taken [a/]	36.5%	14.6%	9.1%

a/ The annual interest rate being charged equals the following:

$$\text{Annual Interest Rate} = \frac{(\text{Principal} * \text{Discount Percentage}) * 365 \text{ Days}}{(\text{Number of Days Net Due} - \text{Number of Days in Discount Period}) * (\text{Principal})}$$

Table 6: Use of Cash Discounts by Local Cooperatives and the Distribution of Percentage Cash Discounts for Cooperatives Having Such Discounts

Description	Number of Cooperatives	Percentage of Total
1. DOES THE COOPERATIVE USE CASH DISCOUNTS?		
a. Yes	51	69%
b. No	20	27%
c. Missing Data	3	4%
d. Total	74	100%
2. WHAT PERCENTAGE CASH DISCOUNT DID THE COOPERATIVE USE? a/		
a. 1 Percent	0	0%
b. 2 Percent	18	24%
c. 3 Percent	8	11%
d. 4 Percent	0	0%
e. 5 Percent	8	11%
f. 6 Percent	1	1%
g. 7 Percent	0	0%
h. 8 Percent	2	3%
i. Missing Data or Did Not Use Percentage Cash Discount	37	48%
j. Total	74	100%

a/ A number of the cooperatives were using absolute cash discounts like 1 cent per gallon of gas or they used both percentage and absolute discounts.

A majority of the cooperatives are using date of billing or a specific day of the month. If a cooperative is going to use such a billing system, prompt billing is important in accounts receivable management. For example, a cooperative bills monthly on the basis of transactions during the previous month. Assume one cooperative is able to mail the bill by the 1st and producers receive the bill the 5th, with a five day discount period and net due on the 15th. Another cooperative is unable to bill until the 10th and their collection process is slowed up by 10 days. If the second cooperative has to borrow an additional $100,000 for ten days a month at 15 percent, the additional interest expense would equal $4,931. Even if the cooperatives would have identical terms, prompt billing will result in some member-patrons paying earlier (see Table 7).

When Do You Send Your Bill Out?

A majority of cooperatives send their bills out on the first of the month. One of the basic questions you may ask is "Why do we do this on that particular day?" Are there sound business reasons for billing on that particular date? If your cooperative has a large number of member-patrons with working spouses, that contribute to the farming operation, you would like your bill to be there when the cash flow is favorable for the member-patron. In the same manner, when do the producers receive their milk checks? Do you want your bill to arrive after everyone else? Know your customer's cash flow and the billing practices of competing firms, since this will determine who gets paid first (see Table 8).

Computerized Billing and Computer Use

Sixty-nine percent of the local cooperatives were using on-line computer service or had a computer on location. Sixteen of the local cooperatives indicated that they did not have computerized billing and 7 did not respond to the question of whether they had computerized billing. The survey demonstrated that cooperatives were operating with a broad range of computer hardware. Those cooperatives not having computerized systems should seriously examine the feasibility of implementing a computer system. Software packages exist for the explicit purpose of managing accounts receivable on micro-computers.

Do not view computers as a solution, they are only a tool. Poor record keeping will not be solved by simply purchasing a computer system. Also, a computer will not collect bills or make sales. The quality of management and employees is probably more important than ever if a computer is incorporated into tools available.

A computer is like any other major capital asset, its purchase should be done carefully. Some of the basic information your cooperative should collect and rules to follow include:

1. Be sure to have competitive bidding on the computer system.
2. Does the software deal with the unique features of a cooperative and the cooperative's product line?
3. What type of support is available in the operation and maintenance of the computer system?

Table 7: The Type of Date Used in Billing of Customers and the Type of Billing Process Used by the Cooperative

Description	Number of Cooperatives	Percentage of Total
1. THE COOPERATIVE'S CREDIT TERMS ARE BASED ON WHICH TYPE OF DATE?		
a. Date of Sale	15	20%
b. Date of Billing	45	60%
c. Specific Day of the Month	10	14%
d. Missing Data	4	6%
e. Total	74	100%
2. DID THE COOPERATIVE BILL ON A MONTHLY BASIS?		
a. Yes	67	90%
b. No	2	3%
c. Missing Data	5	7%
e. Total	74	100%
3. DID THE COOPERATIVE BILL ON A CONTINUOUS BASIS?		
a. Yes	5	7%
b. No	63	85%
c. Missing Data	5	7%
e. Total	74	100%

Table 8: When Cooperatives Mail Out Their Bills for the Month.

Day of the Month	Number of Cooperatives	Percentage of Total
1st	20	27%
2nd	2	3%
3rd	2	3%
4th	3	4%
5th	14	19%
6th	1	1%
7th	2	3%
8th	1	1%
9th		
10th	5	7%
11th		
12th	1	1%
13th		
14th		
15th	7	10%
16th		
17th		
18th	1	1%
19th		
20th		
25th	3	4%
30th	6	8%
Missing Data or Not Applicable	6	8%
Total	74	100%

4. What is the availability of training programs for employees?
5. What is the cost of software revisions and updates?
6. What are the names of current users? Be sure to contact and talk to actual users.
7. Will the computer system meet the cooperative's future needs?
8. What is the financial condition of the software and hardware supplier, i.e. will they be there in the future?

Among the most important activities for collecting information involves talking to an auditor, who audits computer accounting systems. Be sure the computerized accounting system meets the needs of the auditor. The board of directors and management have a major interest in insuring the computerized accounting system can be verified for accuracy.

The board of directors has a major role in the management of accounts receivable. The next section will examine their role in the credit program and accounts receivable management.

The Role of the Board of Directors in Credit Management

The board of directors has the essential role of approving the credit policy and credit program. The board of directors has the fudiciary role in protecting the assets and net worth of the cooperative. An essential dimension of this is the oversight of management in the area of credit extension.

A board of directors should want to adequately monitor the credit program. The best source of information is the aging of the accounts receivable. From the aging of the accounts the board can determine whether the credit collections are lagging or whether the credit policy is being enforced. Eighty-two percent of the boards of directors in the survey did review the accounts receivable at their monthly meetings (see Table 9).

Management should be able to provide the board of directors an aging of accounts receivable at the monthly meeting. If management can not provide a summary of the aging of accounts, questions must be asked about how well management is monitoring the accounts. Given the current stress in the agricultural economy, accounts receivable must be managed closely.

In What Format Are Accounts Receivable Reported to the Board

A majority of the cooperative boards are receiving detailed information on overdue accounts, while an almost even split existed between receiving detailed information on all accounts and a summary of accounts. How much accounts receivable information a board of directors should receive is an area of contention. The standard arguements include:

A. The boards of directors have only a limited amount of time during the meeting and attention should not be addressed at individual accounts except where the cooperative has to initiate special actions such as legal action.

Table 9: The Method Used by Management to Present the Accounts Receivable Aging to the Board of Directors at the Monthly Meetings.

Description	Number of Cooperatives	Percentage of Total
1. The board of directors receives a summary of the accounts receivable aging with no specifics given on credit accounts. Names and amounts in specific account are not supplied the board of directors.	12	16%
2. The board of directors receives all the specifics of all the accounts receivable aging review. Board of directors receive information on names, amounts due, and overdue accounts. Employees and all member-patrons including the board of directors are reviewed.	26	35%
3. The board of directors receives an accounts receivable aging summary, but specific details are discussed on the overdue accounts. This overdue information is supplied on employees and all member-patrons including the board of directors.	21	28%
4. The board of directors receives an accounts receivable aging summary, but specific details are discussed on the overdue accounts. Employee and board of directors accounts are not discussed in this manner, only other member-patrons.	1	1%
5. The board of directors receives all the specifics on only those accounts of individuals not being on the board of directors or not being a cooperative employee.	1	1%
6. Missing data or not applicable	13	18%

B. Management is responsible for implementing the credit policy and credit program. The board should concentrate on key indicators to monitor accounts receivable.

C. Insuring the confidentiality of member-patron accounts and the board's objectivity in evaluating specific actions is hampered by detailed information.

However, some managers like to have board members know which accounts are overdue. The board is used in this case for information gathering in case something unusual develops, this implies a passive role not an active role in collection. This is an issue that must be negotiated between the board of directors and management. However, the board should concentrate on implementation and monitoring the credit program and the overall exposure of the cooperative to bad credit risks.

Board Members Should Not Be Involved in Operations

The board of directors should not become involved in the actual collections of a credit program, that is management's job. Three basic reasons for this position on credit are the following:

1. The board of directors acts as a body. The only exception is when individual members or committees are authorized by the board to act on its behalf.

2. Board involvement will hinder the collection process by lessening the authority of management. In collections, the board members should not let member-patrons play management and the board of directors off against each other.

3. Board members should not be involved with the operational aspects of the credit programs. The role of the board is to approve and monitor the credit program.

Twelve cooperatives or sixteen percent of the survey cooperatives had boards involved in the collection of accounts. This practice has considerable potential for disrupting a cooperative's credit program and frustrating a good credit manager in his/her efforts to implement the board's credit policy and program (see Table 10).

The Board of Directors as Credit Customers

Only 4 percent of the cooperatives did not allow their board of directors to have credit accounts. Thus, board members have access to credit and should realize that as a board member they have legal responsibilities to monitor the credit practices of other board members. As a board member they should not use their position to receive favorable treatment for their accounts.

A significant number of cooperatives did require their board members to have credit applications to receive credit. If the cooperative requires credit applications from its membership, board members have a moral and possibly legal obligation to abide by the cooperative's credit policy.

Table 10: The Role of the Board of Directors in Credit Management

Description	Number of Cooperatives	Percentage of Total
1. ARE ACCOUNTS RECEIVABLE REVIEWED AT THE MONTHLY BOARD OF DIRECTORS MEETINGS?		
a. Yes	61	82%
b. No	11	15%
c. Missing Data	2	3%
d. Total	74	100%
2. DOES THE BOARD OF DIRECTORS EVER BECOME INVOLVED IN THE COLLECTION OF AN OVERDUE ACCOUNT?		
a. Yes	12	16%
b. No	59	80%
c. Missing Data	3	4%
d. Total	74	100%
3. ARE THE BOARD OF DIRECTORS MEMBERS REQUIRED TO HAVE COMPLETED CREDIT APPLICATIONS TO RECEIVE CREDIT?		
a. Yes	23	31%
b. No	43	58%
c. Missing Data	6	8%
d. Total	74	100%
4. ARE BOARD OF DIRECTORS MEMBERS ALLOWED TO HAVE CREDIT ACCOUNTS WITH THE COOPERATIVE?		
a. Yes	67	90%
b. No	3	4%
c. Missing Data	4	6%
d. Total	74	100%

Credit Policies Toward Employees

Cooperatives should have a concise and clear credit policy concerning employees. Sixty-four percent of the surveyed cooperatives indicated they had had an employee become overdue on their credit account. Given the fact, that 8 cooperatives did not allow their employees to have credit accounts, this implies a significant proportion of the cooperatives had problems with overdue employees (see Table 11).

When an employee is hired, the employee should receive training concerning the credit policy of the cooperative and be informed of the consequences of becoming overdue on their account. For example, several cooperatives in the survey indicated that they fired the employee. Having the employee sign a form indicating s/he understands the credit policy towards employees may be useful if some legal action is necessary.

Some evidence of a less stringent credit program for employees than board members was evident. A lower percentage were required to have a credit application of file and were not subject to the same credit review process as member-patrons. Employees should be evaluated, since they represent as much a credit risk as any other credit customer.

Employees must understand that credit management is a high priority in the cooperative. They are the individuals, who must communicate the credit terms to the member-patrons frequently.

Table 11: Credit Policies Concerning Cooperative Enployees.

Description	Number of Cooperatives	Percentage of Total
1. ARE EMPLOYEES ALLOWED TO HAVE CREDIT ACCOUNTS WITH THE COOPERATIVE?		
a. Yes	68	85%
b. No	8	11%
c. Missing Data	3	4%
d. Total	74	100%
2. DO EMPLOYEES HAVE TO FILE A CREDIT APPLICATION TO RECEIVE CREDIT FROM THE COOPERATIVE?		
a. Yes	13	18%
b. No	50	68%
c. Missing Data or Not Applicable	11	15%
d. Total	74	100%
3. DOES THE COOPERATIVE HAVE AN ESTABLISHED POLICY FOR COOPERATIVE EMPLOYEES THAT HAVE OVERDUE CREDIT ACCOUNTS?		
a. Yes	40	54%
b. No	22	30%
c. Missing Data or Not Applicable	12	15%
d. Total	74	100%
4. ARE EMPLOYEES SUBJECT TO THE SAME CREDIT REVIEW PROCESS AS MEMBER-PATRONS:		
a. Yes	58	78%
b. No	6	8%
c. Missing Data or Not Applicable	10	14%
d. Total	74	100%
5. DURING THE PAST THREE YEARS HAVE ANY COOPERATIVE EMPLOYEES BECOME OVERDUE ON THEIR CREDIT ACCOUNTS?		
a. Yes	47	64%
b. No	17	23%
c. Missing Data or Not Applicable	10	13%
d. Total	74	100%

References

1. Devino, Gary T. Agribusiness Finance. Danville, Illinois: Interstate Printers & Publishers, Inc., 1981.

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3. Farm Credit Management Committee. Agribusiness Credit Managers Handbook. The Fertilizer Institute, Washington, D.C., June, 1977.

4. Fassler, Michael L. and Burghardt, William G. "Credit Management for Agricultural Cooperatives: Techniques for Trade Credit Analysis and Planning (Part 1)." The Cooperative Accountant. Vol. XXXVI, No. 3 (Fall, 1983): 26-40.

5. Fassler, Michael L. and Burghardt, William G. "Credit Management for Agricultural Cooperatives: Techniques for Trade Credit Analysis and Planning (Part 2)." The Cooperative Accountant. Vol. XXXVI, No. 4 (Winter, 1983): 17-26.

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APPENDIX I: SAMPLE CUSTOMER CREDIT POLICY

To: All Member-Patrons
From: Board of Directors
Date: October 1, 1984
Topic: New Credit Policy

Effective Date of Stated Credit Policy: November 1, 1984

CREDIT APPLICATIONS:

1. ALL new customers must fill out a credit application in advance of any charge sales.
2. Customers who have not done business with the cooperative or a particular department in recent months may be asked to provide current credit information similar to a new customer.
3. Any customer whose credit has been denied or restricted must provide current credit information before a credit allowance will be reinstated.

CREDIT POLICY & FINANCE CHARGE:

4. Our Coop's Credit Policy is: "All purchases made during the month are due and payable by the 10th of the following month. Any balance not paid by the 15th of the following month shall be subject to finance charges of 1.50 percent per month (18 percent annual), minimum charge of $1.00.

ADMINISTRATION OF CREDIT POLICY
CONVENIENCE CREDIT:

5. We have directed Management to administer the Coop's credit policy as set up in the by-laws of Your Cooperative to issue CONVENIENCE CREDIT to worthy patrons and to refuse credit privileges to any patron whose account is in violation of the Coop's credit policy.

CASH DISCOUNTS (10 Days):

6. A three percent (3%) cash discount will be allowed on all sales of farm supplies and grain if paid within 10 days of date of purchase.
   Note I: This only applies if you owe nothing which is older. In other words, all payments will be applied on the oldest amount on your account.
   Note II: This means payments must be in a negotiable form and in our hands -- no later than 10 days. If you intend to use the mail service, then it must be postmarked no later than eight days after date purchased.

CASH DISCOUNTS BY 10TH OF MONTH:

7. A two percent (2%) cash discount will apply on all current accounts paid in full by the 10th of the following month (per your monthly statement). Notes I and II above apply.

FERTILIZER - AG - CHEMICALS:

8. There may be special datings and discounts on fertilizer and ag chemicals in season - ask.

EXTENDED TERMS

Extended terms for credit may be arranged by consulting with management and providing them with current financial statements and/or issuing proper security agreements as collateral for your account. An appointment with management should be made by you if extended terms are necessary. This must be done in advance of credit needs.

INTERPRETATION OF RULES

If there is to be a credit policy with any rules to follow, then they must be adhered to by everyone. We need your cooperation.

We realize that with the state of the farm economy as it is now the availability of ready cash for each of us is not easy, but, we ask for your cooperation in understanding the position of your Cooperative and its need for a steady cash fow to meet its obligations to suppliers providing us with our farm products. If you have any questions or comments, please visit with our Management. Any problems we have can be resolved fairly if we communicate. We encourage our members to do their financing at their local bank or Production Credit Ass'n. They are in a position to do a better job of providing credit services than we can.

APPENDIX II: SAMPLE CREDIT APPLICATIONS

YOUR COMPANY

FARMER CREDIT APPLICATION

Name ______________________ Date ______________

Address ______________________ ☐ Individual Phone ______________

☐ Partnership ☐ Corporation

Age _____ Soc. Sec. No. or Fed. Empl. No. ______________________

If partnership, names and ages of principals

____

____

Other persons authorized to charge purchases to this account:

____

____

Landlord(s) ____

Address (Landlord(s)) ____

Acres Owned _________ Acres Rented _________ Total Acreage _____________

Crop Acreage: Corn ____ Wheat ____ Cotton ____ Soybeans _____ Citrus _________

Vegetables _____ Milo ____ Rice _____ Other Specify _____________

Number and Kind of Livestock ____

List all lenders or lines of credit for which applicant is borrower, co-borrower, guarantor or otherwise (if none, state none)

Lender's Name, City and State	Purpose	Approximate Amount of Loan or Line of Credit

Banks, savings and loans and other financial institutions handling applicant's checking and savings accounts or certificates of deposit.

Financial Institution	Address

List sources and approved amounts of income other than farming (such as Salaries, Investments, Rent, etc.)

____

____

List suppliers of major production inputs (Such as fertilizer, chemicals, feed, seed, etc.)

____

____

The information given herein is true and is given to cause _______________ Company to rely on it for the purpose of extending credit to applicant. I authorize the references named herein, both financial institutions and trade suppliers, to release any financial and credit information known to them to __________________ Company with the understanding that it will be used solely for credit purposes.

Disclosures of terms and conditions of credit sales have been included herewith and are acknowledged.

Signature ______________________

(NOTICE TO READERS:)

The author recommends that an application form similar to this also include a credit agreement form which the applicant executes and retains a copy. This agreement form should contain the specific terms and conditions of the dealer's credit but must meet the requirements of both Federal and State regulations dealing with credit disclosures and/or interest rates. Because of the many variances in credit term procedures which affect the wording in the disclosure statement, it is felt that local counsel should be obtained to design such a form.

It is also recommended that the disclosure required by State and Federal regulations concerning "Truth in Billing" be included with a credit application form.

Farm Credit Management Committee. Agribusiness Credit Managers Handbook. The Fertilizer Institute, Washington, D.C., June 1977.

CREDIT APPLICATION

Date____________

Name______________________________ Age________ Married________

R.F.D._____________________________ Dependents____________

City________________________ State____________ Phone________

Wife's Name____________________ Employed_____ Employer__________

Wife's Income______________/Month

BANK: Name________________________ Address__________________

FARM OPERATION:

1. Size of Farm:__________ Acres __________ Tillable Acres
2. Operation: ________ Crop ________ Dairy ________ Hogs ____ Beef

REASON FOR CREDIT:

1. Amount Requested____________
2. Reason____________
3. Date of Repayment____________
4. Method of Payment____________

FINANCIAL:

I. Income: Please state net income for past three (3) years

19__ $__________ 19__ $__________ 19__ $__________

II. Assets:

Asset	Value (net)	If insured, how much?
1. Land		
2. Equipment (car)		
3. Grain		
4. Livestock & Poultry		
5. Other		

III. Liabilities: A. Loans

Creditor			
Balance			
Date Due			
Monthly Payment			

B. Mortgages

Mortgagor			
Balance			
Date Due			
Monthly Payment			

IV. Credit References

Name			
Address			
Amount			
Payment			

Signature____________________

Downey, Dave, John Marten, and Steve Erickson. Principles for Profit: A Handbook for Agribusiness. EC-506, Cooperative Extension Service, Purdue University, West Lafayette, Indiana, February 1980.