

WORKING CAPITAL EFFECTIVENESS – IMPROVING PROCESSES, TOOLS & HABITS

Tuning Up Accounts Receivable

The Pursuit of Best Possible Days Sales Outstanding (DSO)

Improving Accounts Receivable Effectiveness

Given the current economic and credit conditions, now is the time to be sure your accounts receivables (A/R) are in tip top shape. A/R process improvements can often yield quick results with a relatively small amount of effort. Examples of common opportunities include developing early payment discounts, being more proactive in soliciting payment, and breaking down the silos around A/R departments when dealing in customer relationships.

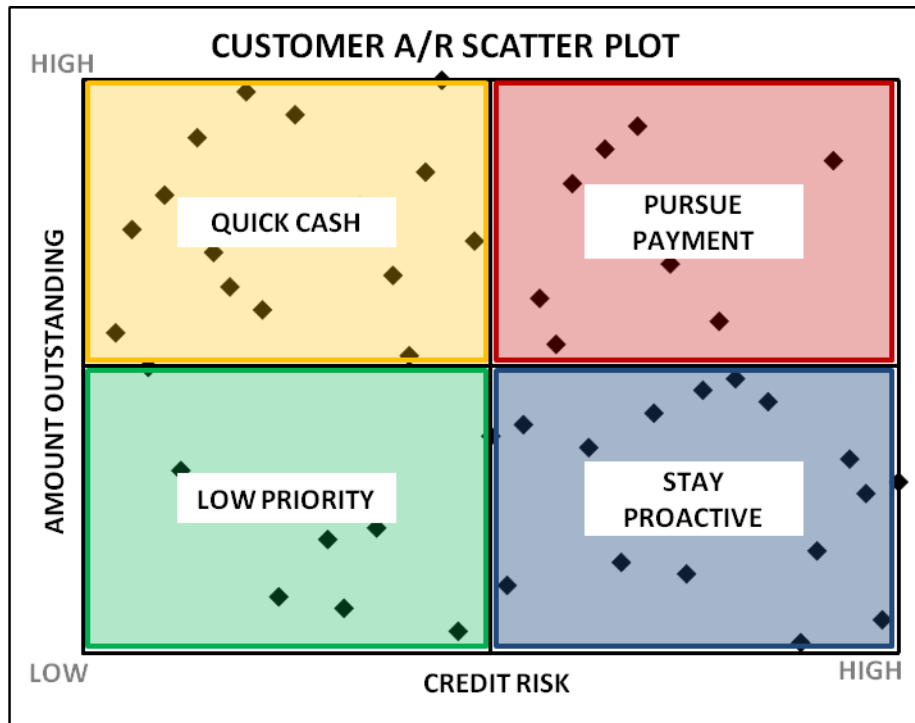
Time Value of Money & Early Pay Discounts

One of the first steps toward achieving strong performance in A/R is ensuring they have a clear understanding of the value of cash to the business. A thorough analysis with transparent assumptions that can be reviewed and tweaked continuously by the CFO or otherwise will align the business on the value of pursuits including early pay discounts, late pay penalties, etc. The key here is to make this an ever developing tool. When cash needs change – for whatever reason – the value of collecting from customers early at a discount goes down compared to collecting the full invoice at the due date.

Customers' responses to early pay discounts are often as valuable as the cash flow itself. For example if very few customers take the discount it could be a sign that either they value their cash at a higher rate than the discount offered, or worse, that they may not be able to pay. Obviously knowing before the invoice due date that a customer may be unable to pay is worth something compared to finding out when the account goes past due. The inverse is also true, if a customer is known to be a relatively high credit risk, a strategy for collecting from that customer may include an aggressive and structured early pay discount promotion.

Tactical and Proactive Pursuit of Payment

Once A/R has a clear understanding of the organization's time value of cash, and is well prepared to manage customer credit profiles, they must put into place a proactive process to collect. In top A/R groups, this is far more than just 'dialing for dollars.' The process must be set up such that customer accounts are addressed proactively and consistently. Triggers should be put into place to ensure that the most important accounts are managed closely. For example, many successful collections groups stratify their customers by amount due and by credit risk. Consider the following scatter diagram:



Where each dot on the scatter plot represents a specific customer, this can lead the effort to create processes for collections. For example, if normal terms of payment are 30 days from invoice, customers in the upper right quadrant may receive an email 7 days after invoice and phone calls every 7 days thereafter. On the other hand customers in the lower right quadrant could be addressed with phone calls on days 10, 20, and 30. Another way to approach this may be to pursue payment from customers based on internal circumstances, for example call customers in the top left quadrant when total amount outstanding reaches X% of sales.

Customer Relationship Management

Besides impacting cash-flow, using the time value of money and segmenting customers to drive collections activities will very quickly start pushing the normative boundaries of A/R. At this point organizations either ramp up to the next level or allow the norms to bring them right back to the old methods of the past. A surefire hint that it is time to break down the silos around A/R is when the sales force is feeling impeded upon by the collections group. Rather than a knee jerk reaction to let the sales force manage the customer relationship, stick to the tools at hand. Use the value of cash to create a collaborative effort with both amounts outstanding as well as further sales potential in mind. A small amount of creativity can go a long way here. For example, consider offering an early pay discount where the discount will apply to the next purchase if the current outstanding invoice is paid in full today or an invoice due date extension if a new order is received today.

Effective A/R Processes Yield Benefits Beyond Cash-flow

While the core competency of A/R should be to collect on invoices, it can be a group that provides significant other value to the business as a whole. By understanding the constantly changing value of cash to the business and customers' responsiveness to payment incentives can give the business a more precise snapshot of upcoming cash-flows. With this insight, tactical collections activities can be leveraged for the best return, or as the case may be – the least exposure. Finally by making the A/R group part of any ongoing sales efforts, sales can be tailored to optimize the cash-flow needs of the customer as well as the business.